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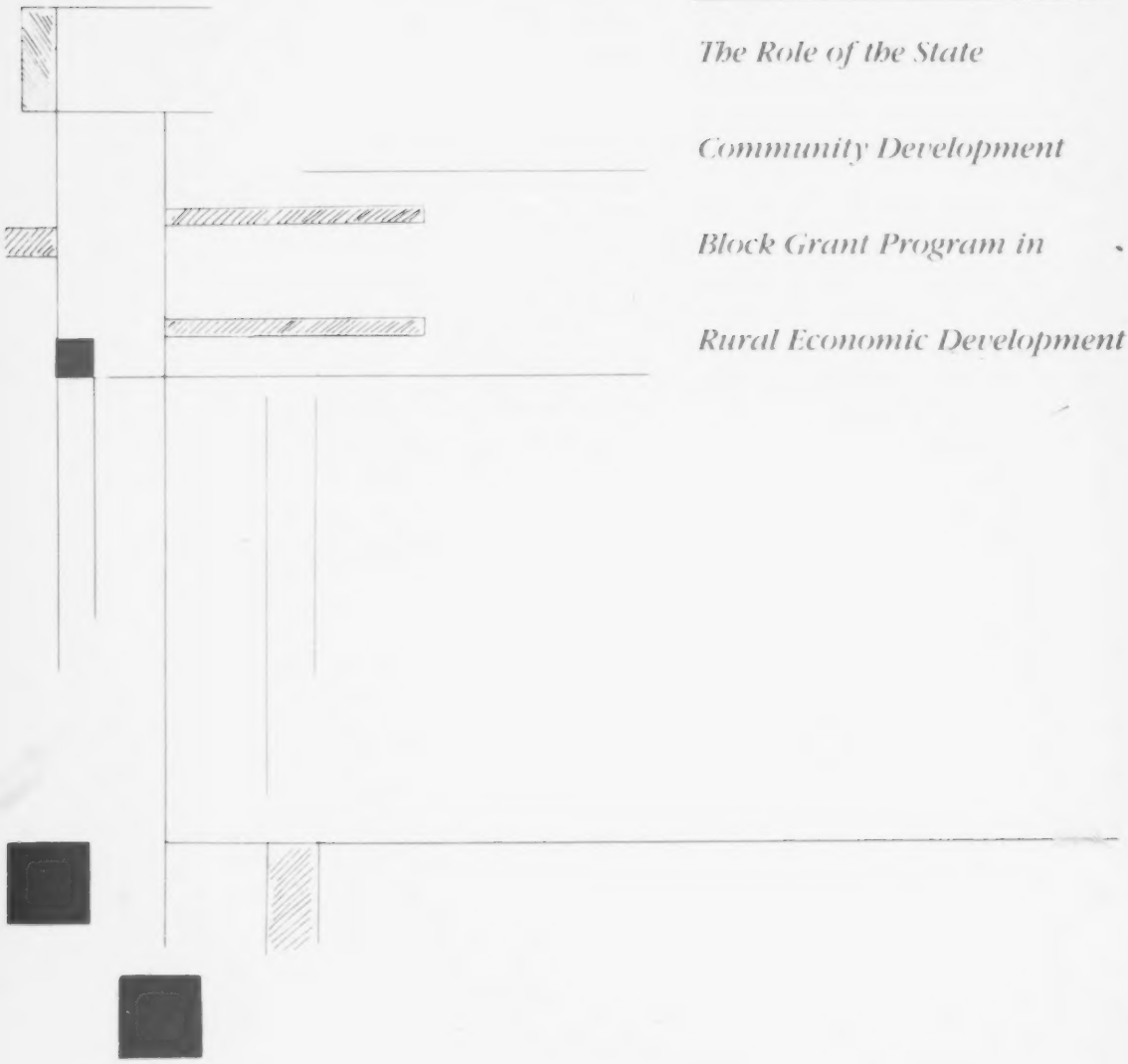
ASSISTING RURAL ECONOMIES

The Role of the State Community Development Block Grant Program in Rural Economic Development



Council of State Community Affairs Agencies

COSCAA

ASSISTING RURAL ECONOMIES

The Role of the State Community Development Block Grant Program in Rural Economic Development

By

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Washington, D.C. 20001

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PREFACE

Assisting Rural Economies is the first thorough description of how the State Community Development Block Grant (CDBG) Program was used for rural economic development. It is the first of four reports produced by the Council of State Community Affairs Agencies (COSCAA).

This report examines the distribution of State CDBG funds that are used for economic development: the geographical distribution of grants among local governments and among different kinds and types of businesses. The primary emphasis is on whether the "ruralness" of the local governments that received CDBG grants was associated with differences in the kinds of economic development assistance provided by the grants. The report also looks at whether differences in local economic base or local demographic or socioeconomic characteristics affected the uses of State CDBG Program grants. Finally, the report compares the characteristics of the business assisted through the CDBG Program with characteristics of the rural economy. Thus, the report illustrates the importance of the State CDBG Program to rural economic development and the ways the program has been used to assist rural economies.

One way to delineate the scope of a report is to indicate what it is not. This report does not present a comprehensive overview of the CDBG Program. While the report briefly reviews the major characteristics of the CDBG Program, it quickly focuses on the economic development aspects of the State CDBG Program.

Second, the report is not an examination of rural economic development. It concentrates solely on the use of State CDBG funds. It does not attempt to examine the use of other public subsidies or assistance. Although references are made to rural economic development literature and linkages are made to the characteristics of the rural economy, the analysis is limited to one facet of rural economic development.

Third, the report is concerned only with the immediate uses of the State CDBG Program for rural economic development. In other words, the report is concerned with what might be called outputs, not outcomes. The report does not identify the number or kinds of jobs created or retained by the State CDBG Program or the specific uses to which businesses put CDBG loan assistance. The jobs mentioned in this report are the jobs that local governments and states expected to be created or retained when the grant contract is executed. A second report produced by COSCAA, which is based on a survey

of over 400 business that received State CDBG loans, examines job creation and retention and loan characteristics specifically.

This report does not examine State CDBG decision making or state rural economic development policy. A third report, which is based in part on eight case studies, examines decision making in the State CDBG Program as it relates to rural economic development, and how states used the CDBG Program as part of a comprehensive approach to rural economic development. This is an important point to note because the report deals with aggregate data from all the states participating in the program. Yet, within broad national parameters that largely deal with eligible activities and national objectives, states can tailor the CDBG Program to their specific conditions and goals. Thus, the State CDBG Program can be viewed as a decentralized program that can be responsive to the policy goals and economic conditions of the 48 administering states and Puerto Rico. These policies and economies can be very different from one another and aggregate analysis can diminish the conscious fine-tuning that may occur in each state.

ACKNOWLEDGEMENTS

Many people contributed to this report. COSCAA thanks particularly State CDBG Program personnel for the time they took to complete the surveys and for their patience in providing follow-up information. Thanks is also due to Susan Sechler of the Aspen Institute for Humanistic Studies for her perceptive comments on a draft of the report and to the institute's Rural Economic Policy Program and to the Ford Foundation's Rural Poverty and Resources Program for sponsoring the entire project. Beth Siegel of Mt. Auburn Associates prepared and revised cross-tabulations from the database prepared by COSCAA with skill and fortitude. Brandon Roberts was the project director for COSCAA and provided insightful guidance throughout the entire project. A special acknowledgement must go to Taynia Mann, who drafted the survey and supervised the survey responses and preparation of the database, a task that demanded attention to detail and persistence over a long period. Gail Webster and Pat Smith prepared the manuscript. Finally, COSCAA thanks the many people who reviewed various drafts of the report for their comments, criticism and suggestions. The reviewers helped improve the quality and accuracy of the final report. The author, however, is fully responsible for the content of the report. The opinions expressed in the report are solely his, and do not necessarily represent the views and opinions of COSCAA or the members of COSCAA.

EXECUTIVE SUMMARY

The State Community Development Block Grant (CDBG) Program is the major federal resource for rural economic development loans and grants. Between 1982 and 1988 states administered roughly $7 billion in CDBG Program funds, using about a quarter of these funds for economic development. Local governments used State CDBG funds for economic development to provide infrastructure assistance and credit assistance to businesses for purposes of job creation and retention, primarily for lower- income persons. This report examines the use of State CDBG funds for rural economic development between 1982 and 1986.

Local governments in metropolitan and nonmetropolitan areas are eligible to use State CDBG funds, but states focused on rural areas, allocating about 72 percent of their CDBG economic development funds to nonmetropolitan areas. Although Congress authorizes states to receive only 30 percent of the total CDBG funds appropriated (the U.S. Department of Housing and Urban Development uses 70 percent of the funds to provide money directly to large size cities and counties, called "entitlements"), the State CDBG Program is the federal government's primary resource for direct loan and grant assistance for job creation or retention in rural areas.

A study of how State CDBG funds were used for rural economic development is important not only because of the size of the program, but also because of the program's flexibility. This report attempts to show the extent to which the State CDBG Program is an economic development program for rural areas, the types of economic development activity funded, the kinds of businesses assisted, whether the degree to which a local government is rural affected the economic development use of the program, whether the nature of a rural county's economic base affected the use of CDBG funds, and to what extent and how State CDBG funds were used in poorer or more distressed rural areas. It pays special attention to the roles played by manufacturing and nonmanufacturing industries and by complex and routine manufacturing industries because of the emphasis on these industries in the rural economic development literature.

A Major Economic Development Resource for Rural America

As noted above states allocated about 72 percent of their CDBG economic development funds to nonmetropolitan areas. Approximately the same percentage of CDBG-assisted projects were located in nonmetropolitan areas. From a rural perspective this is a favorable allocation, because non-

metropolitan areas contain only about 55 percent of the population residing in state-eligible local governments. States continually made the program more rural over time, increasing both the percentage of funds allocated to and the projects located in nonmetropolitan areas.

While "nonmetropolitan" is the mostly widely used definition of rural, nonmetropolitan areas can include some very urbanized areas. The study divides nonmetropolitan counties into six groups depending on the urban population in a county (more than 20,000, less than 20,000, or completely rural) and whether a county is adjacent or nonadjacent to a metropolitan county. This grouping of nonmetropolitan counties represents a continuum of six groups of counties arranged by what is often called the urban influence continuum, with the first group representing nonmetropolitan counties under the most urban influence and the last group, the least urban influence.

The study shows that states allocated over one-half of their CDBG funds and over one-half of the projects to the four most rural groups of nonmetropolitan counties. Additionally, the three most rural groups of counties received about one-third of the funds and projects. Using this definition of rural, states made the program more rural in focus over time. The distribution of CDBG funds and projects among the six groups of rural counties fairly well matches the distribution of population among the six groups of counties.

Infrastructure Assistance and Business Loans

The study attempts to summarize the characteristics of CDBG-assisted economic development activity, and to determine whether the uses of CDBG funds for economic development varied by several different rural variables. Generally speaking, there were no major differences in how CDBG economic development funds were used based on how rural the area was where the CDBG project was located. There were several differences, and these will be identified shortly, but by and large four themes dominated the use of CDBG for economic development regardless of the location of the CDBG-assisted project.

First, states used CDBG funds primarily for loans to businesses and not for infrastructure assistance. States used about 68 percent of the funds to provide, through local governments, loans to businesses. Because the average grant size was larger for infrastructure assistance projects than for business loan projects, 70 percent of the projects were business loans. The percentage of economic development projects that were business loans increased over time, from 56 percent in 1982 to 78 percent in 1986. One explanation for this increasing loan use is that as states and local governments became more com-

fortable in using CDBG funds for loans, they were able to move away from the more traditional and familiar public works activity. Also, the nature and size of the businesses being assisted probably also warranted a shift from infrastructure assistance to loans.

Second, states used CDBG loans primarily to assist existing businesses and start-ups. About 45 percent of all business loan projects were expansions, about 25 percent were start-ups, and 9 percent were retentions. Less than 13 percent of all business loan projects were interstate or intrastate relocations, 6 percent were branch plants, and franchises accounted for 2 percent. However, expansion and start-up projects used smaller loans than did branch plants and relocations. So, states allocated 22 percent of their CDBG business loan funds to start-ups and 39 percent to expansions, while providing 9 percent to branch plants and 16 percent to relocations. Without question the use of the State CDBG Program for rural economic development further explodes the stereotype of branch plants and relocations being the keys to rural business development.

Third, state CDBG loan assistance focused on manufacturing industries: about 68 percent of the businesses that received loan assistance were manufacturing industries. Because the size of the average manufacturing industry loan was larger than the average nonmanufacturing industry loan, nearly 80 percent of the CDBG funds used for loans went to manufacturing industries. The states increased their concentration on manufacturing industries over time, raising the percentage of loans going to manufacturing industries from 57 percent in 1982 to 76 percent in 1986. The percentage of total planned CDBG-assisted employment represented by manufacturing industries was more than triple the percentage of total actual employment represented by manufacturing industries. Further, most of the manufacturing projects and most of the planned manufacturing employment were in routine industries and not in complex industries.

Finally, states concentrated their CDBG loan assistance on very small businesses. Over two-thirds of the businesses that received CDBG loans had 25 or fewer employees, and nearly 87 percent had 100 or fewer employees. The information on the size of the businesses assisted is consistent with the relatively substantial funding of start-ups as nearly every start-up had fewer than 26 employees. The emphasis on small business assistance remained somewhat stable over time. Because the average loan size was smaller for the smaller businesses, businesses with fewer than 26 employees received 55 percent of the loan funds, while businesses with more than 500 employees received about 23 percent of the loan funds, although they comprised only 13 percent of the business loan projects.

Rural Differences in Using CDBG for Economic Development

The use of the CDBG program for economic development varied depending on the characteristics of the areas that received the funds.

Metropolitan areas used more CDBG funds for infrastructure assistance than did nonmetropolitan areas. The use of CDBG funds for infrastructure assistance varied little among the urban influence continuum, although nonmetropolitan counties adjacent to metropolitan areas tended to have the highest percentage of infrastructure projects. The major differences in the relative use of CDBG funds for infrastructure assistance occurred among counties of different economic bases. Agricultural, mining, and federal lands counties made much less use of CDBG funds for infrastructure assistance than did the counties with other economic bases. The data in the report suggest that urban or urbanizing areas or areas adjacent to metropolitan areas are the areas that tend most to need infrastructure assistance for economic development.

Only slight variations existed regarding the kinds of businesses assisted. The biggest difference was that start-ups were relatively more frequent in nonmetropolitan counties that were adjacent to metropolitan counties and much more dominant in federal lands, mining, and government counties than in counties with other economic bases. Given the demographic nature of the counties that provided relatively more assistance to start-ups, the data in the report reinforce the notion in the rural development literature that being adjacent to metropolitan areas or urban markets is a strong indicator of economic growth potential. Metropolitan areas tended to provide relatively more assistance to relocations than did nonmetropolitan areas. Among nonmetropolitan counties, relocations tended to be relatively more frequent in counties nonadjacent to metropolitan counties. Relocations were much more frequent in agricultural counties and much less frequent in manufacturing counties. Branch plants were relatively more frequent in nonmetropolitan areas than in metropolitan areas and much more frequent in manufacturing counties than in counties with other economic bases, with agricultural counties assisting by far the lowest relative proportion of branch plants.

Nonmetropolitan areas tended to assist very small businesses relatively more frequently than metropolitan areas. Within nonmetropolitan areas the most rural counties provided relatively more assistance to very small businesses. The data in the report suggest that very small businesses and start-ups are very important to and potentially viable in rural areas, even in very rural areas, notwithstanding the view in the rural development literature that rural

areas are not conducive to start-ups and very small businesses because they are dominated by slow growth industries.

Metropolitan and nonmetropolitan areas each assisted manufacturing industries with the same frequency, but metropolitan areas assisted many more businesses in the finance, insurance, real estate and business service industries than did nonmetropolitan areas. Relatively, nonmetropolitan areas assisted more businesses in mining and wholesale trade than did metropolitan areas. Mining and federal lands counties assisted manufacturing industries much less than did counties with other economic bases, especially manufacturing counties, which most predominantly assisted manufacturing industries.

Metropolitan areas were able to develop higher leveraging ratios than nonmetropolitan areas, and this was especially true for private leveraging. Among nonmetropolitan counties, the lowest leveraging ratios, both public and private, occurred in the most rural counties. The most rural county group was particularly disadvantaged by a very low private leveraging ratio. The data in the report suggest that economic development projects in the more rural counties cannot raise as much capital, especially private capital, as projects in less rural counties.

The average CDBG cost per planned job was higher in nonmetropolitan areas than in metropolitan areas. Within nonmetropolitan areas the average CDBG cost per planned job tended to be higher in the more rural counties. The most rural group of counties had the highest average planned job cost reinforcing other studies that show the cost per job tends to be higher the more rural the area.

Economic Development in Distressed Areas

States are not required to target CDBG funds to distressed areas, but many states do use measures of distress in scoring and rating applications for CDBG assistance. States fund nearly all economic development projects under the national objective of benefitting low- and moderate-income persons, which generally means that each economic development project must employ persons at least 51 percent of whom have incomes of 80 percent or less of the state nonmetropolitan median income or county median income, whichever is higher.

States tended to fund economic development projects in their poorest counties, when the funded counties' averages for such variables as poverty, per capita income, and unemployment are compared to their state's averages for the same variables. This is to be expected since nonmetropolitan averages for

these variables are invariably lower than statewide averages. When compared to national nonmetropolitan averages for poverty and per capita income, however, it appears that states may have funded counties whose per capita incomes are slightly higher than the state nonmetropolitan per capita income and whose poverty ratios may be slightly lower than the state nonmetropolitan poverty ratio.

To a very significant degree states tended to fund projects in counties with unemployment rates very much higher than the state's average unemployment rate. Additionally, states tended to fund projects in counties with population growth rates slightly lower than the state's average population growth rate.

Counties with lower per capita incomes tended to use CDBG funds more for business assistance, tended to fund a higher percentage of start-ups and very small businesses, and tended to fund a lower percentage of interstate relocations and retentions than counties with higher relative per capita incomes. Persistent, or long-term, poverty counties present somewhat of an anomaly because they used CDBG funds for relatively more infrastructure assistance projects than did non-persistent poverty counties. Persistent poverty counties also funded relatively more manufacturing businesses. Finally, counties with relatively much higher unemployment rates tended to fund a much higher percentage of very small businesses.

Policy Implications

The final chapter draws several implications for public policy based on the study. One implication is that a policy designed to provide employment to lower- income persons in rural areas may not be consistent with a policy designed to strengthen the long term viability of rural economies, although both policies may have equally desirable goals. Most of the planned employment in CDBG-assisted businesses was in routine manufacturing industries, possibly because it is so much easier to hire lower- income persons in routine manufacturing industries than in complex manufacturing industries. While this may provide immediate employment to lower- income persons, it may not help build long- term economic strength in rural areas. For example, routine manufacturing employment decreased by 11.7 percent between 1979 and 1986 and is expected to decrease by 2.9 percent between 1984 and 1995. On the other hand, complex manufacturing employment increased by 2.9 percent between 1979 and 1986 and is expected to increase by 17.8 percent between 1984 and 1995.

The report makes several suggestions for changes in the CDBG Program to reconcile this possible inconsistency. One is to permit CDBG funds to assist

businesses in very poor rural communities under the "slum and blight" national objective, which would not require that a majority of new employees be lower income persons. A second is to encourage greater use of CDBG funds to provide job skills to lower- income persons.

Another suggestion is to modify the CDBG Program so that it is a more effective resource for assisting very small businesses and start-ups in rural areas. Among these changes are allowing states to use some CDBG funds to provide technical or management assistance to very small businesses and start-ups without having to grant the funds to a local government for an eligible activity, and permitting states to require that program income be returned to the state.

These suggestions for change should not obscure the success states have had in using the CDBG Program to respond to different rural economic development problems, work in many different kinds of rural areas, especially in rural areas of high unemployment, assist very small businesses, start-ups, and existing businesses, and provide employment to many lower- income persons.

I. INTRODUCTION

This report examines the states' use of Community Development Block Grant (CDBG) Program funds between 1982 and 1986 for rural economic development. Although the CDBG Program is generally thought of as an urban neighborhood revitalization program, states spend a large majority of the funds in rural areas and a significant amount for economic development. Consequently, the State CDBG program is the major federal resource for rural economic development loans and grants, and state governments are important policy and program participants in the development of small communities.

The State CDBG Program

In 1981 Congress enacted two major changes in the Community Development Block Grant Program as part of the Omnibus Reconciliation Act. These changes took effect in the 1982 program, or fiscal, year.

One change gave state governments the option of administering what up until then had been called the "Small Cities" program. CDBG funds are split between large cities and counties, or entitlements, and small cities and counties. Seventy percent of the CDBG funds appropriated annually by Congress, which have averaged about $2.9 billion a year from 1982 through 1989, are allocated by the U.S. Department of Housing and Urban Development (HUD) on a formula basis to the entitlement localities, which are generally cities with populations of 50,000 or more, and counties with either unincorporated populations of 200,000 or more or representing consortia of unentitled local governments with a combined population of 200,000 or more.

HUD allocates 30 percent of the money among states to be granted to nonentitled cities and counties. This report covers that 30 percent of CDBG funds. States can distribute their CDBG funds to local governments in both metropolitan and nonmetropolitan areas as long as the localities are nonentitled jurisdictions. In 1986, about 42 percent of the nation's population resided in nonentitlement localities. Of this amount, about 45 percent resided in metropolitan areas and about 55 percent resided in nonmetropolitan areas.

A state has the option of administering the CDBG Program itself or of having a HUD field office administer it. In 1982 Puerto Rico and 37 states chose to administer the CDBG Program; an additional 10 states chose to manage the program in 1983, and one more state came into the program in 1984. Currently all states but New York and Hawaii administer the program.

States must distribute CDBG funds as a grant to a unit of general purpose local government. Nearly every state distributes most or all of its CDBG economic development funds to localities on the basis of competitive applications.

The second major change Congress enacted in 1981 allowed CDBG assistance to for-profit businesses. Before 1981, economic development was an eligible activity only when carried out by a community-based nonprofit organization under contract to a local government, and very little economic development was funded through the HUD-administered CDBG Program. States quickly made significant use of this change. By 1984 states were using about 25 percent of their CDBG funds to assist for-profit businesses. However, since 1984 a decreasing percentage of State CDBG funds has been used for economic development. States used an estimated 22 percent of CDBG funds between 1982 and 1986 for economic development.

The State CDBG Program is much more than an economic development program, however. First, a wide range of other activities is eligible for funding, including housing (generally excluding new construction), public facilities, and public services, which is limited by law to 15 percent of a local recipient's funds.

From 1982 through 1989, states managed about $7 billion of Community Development Block Grant funds. States allocated about one-half of these funds for public facility activities, primarily for wastewater treatment and water supply, but also for storm drainage, streets and roads, and solid waste disposal. States used about one-fourth of the money ($1.75 billion) for housing, mostly for housing rehabilitation for homeowners. A relatively small amount of funds was used for community facilities, day care centers, homelessness assistance, job training, and other services, including technical assistance and capacity building. Nearly one-quarter of the funds were spent on economic development.

Second, each State CDBG activity must meet one of three statutory national objectives. Most activities address the primary national objective, to benefit directly persons of low and moderate income. In the state program low and moderate income is now defined as 80 percent of the median income of the county where the activity takes place, or 80 percent of the state's nonmetropolitan median income, whichever is higher. An activity meets this national objective if 51 percent or more of its beneficiaries are low- and moderate-income people. The other two national objectives are to prevent or eliminate slums or blight and to meet urgent community needs. Only about

4 percent of the funds are used for activities that qualify under either of these two national objectives.

States generally allocate CDBG funds for two broad types of economic development activities. One is the funding of public works projects directly related to job creation or retention, and the other is the provision of credit assistance to businesses for job creation or retention. Between 1982 and 1986, local governments in metropolitan and nonmetropolitan areas used about 68 percent of State CDBG economic development funds for loans to businesses and about 31 percent for economic development infrastructure.

Infrastructure assistance is almost invariably in the form of grants; the money is not loaned, and the program receives no direct return and no program income. On the other hand, business loans are just that -- they are almost invariably funds loaned to a business which must be repaid either to the local government or to the state. The loans usually carry lower interest rates or more favorable terms than can be found in private financial markets. Program income is an important characteristic of the use of CDBG funds for economic development because it enables CDBG funds to expand and recirculate. Much of the program income is used to meet the national objective of benefiting low- and moderate-income persons.

Although business and employment development may be at the core of rural development, the State CDBG Program can be used to support activities in the entire spectrum of rural development. COSCAA's data for the State CDBG Program from 1982 through 1986 suggest that community-wide public facilities funds are distributed more substantially to nonmetropolitan areas and to the more rural counties in nonmetropolitan areas than are economic development funds. As noted above, about one-quarter of State CDBG funds, and more so in just the past couple of years, are used for housing. Recently states have begun to use the CDBG Program for a variety of innovative projects involving community facilities, day care, and job training, as well as activities designed to increase the self-sufficiency of people on welfare in rural areas. A small portion of economic development funds are used for feasibility studies, economic development planning, and technical assistance.

Nonetheless, because economic development is central to rural development, this report limits its scope to direct job creation and retention activities. The report is based on data COSCAA collected from the states that cover about $737 million distributed in 3,303 economic development projects, which represents about 75 percent of the estimated $990 million distributed by states for economic development activities during this. Appendix A provides more

information on data collection and methodology, and Appendix B includes a copy of the survey.

States and the Development of Small Communities

States play an important role in the development of small communities and rural areas in addition to providing CDBG funding Program. Because many small communities and rural areas lack adequate resources, institutional capacity, and personnel expertise, much of state governments' technical assistance and capacity building activities are directed toward rural areas. For example, the Pennsylvania Department of Community Affairs provides an extensive array of training and consultative services to local governments and community-based nonprofit organizations in small communities and rural areas.

Another reason for the states' involvement in rural development is the extraordinary level of state involvement in economic development, particularly in the past ten years. One only has to look at governors State of the State messages and state budgets to grasp the attention states have been paying to economic development.

This new wave of state economic development goes beyond industrial solicitation and tourism promotion. Export assistance, business credit assistance, especially to small firms and fledgling entrepreneurs, enterprise zones, business incubators, farm assistance, infrastructure for economic development, customized job training, linking educational and business resources, particularly in regard to high technology and science activities, and labor-management relations are some of the activities states fund in their attempt to bolster local economies, assist existing and new businesses, and create, retain, and upgrade jobs. David Osborne in his monograph *Business Competitiveness: The States Take the Lead* and in his book *The Laboratories of Democracy* has chronicled state economic development efforts in a particularly noteworthy way.

Many of the states' significant economic development initiatives take place in, or directly benefit, small communities and rural places. Unfortunately, state economic development efforts that focus on rural areas or directly benefit rural areas have not been surveyed systematically and identified. This report is one step toward communicating the states' extensive involvement in rural development. Nonetheless, the following examples illustrate the breadth of state participation in rural economic development. [1]

One type of state activity for rural development involves providing information to and increasing the capabilities of rural institutions. Iowa's Economic Development Network has a computer linkage to a research and market center to help rural businesses gain better access to customers and suppliers. South Carolina cosponsors a Rural Development Leaders school, an intensive four-day training session for rural community leaders. The North Dakota Job Service has 65 information centers in localities with of fewer than 1,000 people. The legislatively – created Office of Rural Development in the Georgia Department of Community Affairs acts as a clearinghouse for information, data, resources, and assistance for rural community needs.

Certainly a key activity for many states is the provision of financial resources for rural development. Minnesota's Challenge Grant Program, administered by the state's Rural Development Board, provides grant capitalization for regional revolving loan funds. The Illinois Rural Affairs Council oversees the spending of at least 25 percent of state agency budgets in rural areas. Montana's Agricultural Development Council helps create incubators for agricultural-related businesses, assists rural businesses in exporting to Pacific Rim countries, and makes seed capital grants available for new product development. Nebraska's Employment and Investment Growth Act and its Employment Expansion and Investment Incentive Act provide financial assistance for new investment and job creation. Michigan's Capital Access Program is a reserve for losses incurred by banks when they lend money to small businesses in rural areas.

States also provide financial assistance for infrastructure investment in rural areas, through direct appropriations or state bond banks. States have dramatically increased financial assistance for rural housing, and they are increasingly recognizing the importance of health, job training, and education investment to rural economic development.

Unfortunately, the national policy community – including Congress, federal agencies, public interest groups and trade associations, and policy research institutions – often does not recognize the role of states in rural development. For example, a January 1989 report of the U.S. Department of Agriculture (Lyng and Vautour) contains this paragraph early in its executive summary:

> Financial resources, in the form of loans, grants, and loan guarantees are provided to Rural America by a number of Federal entities including the Farmers Home Administration (FmHA), the Rural Electrification Administration (REA), the Small Business Administration (SBA), the Economic Development Administration (EDA) and many nonobvious organizations such as

> the Environmental Protection Agency (EPA), the Justice Department and the Department of Defense. These resources help Rural Americans pursue a wide range of activities from business development to building and repairing essential infrastructure such as roads and bridges. A number of Federal organizations provide physical resources to Rural America that help in rural development efforts, including the Departments of Agriculture, Interior, Transportation, Energy, Defense and the Tennessee Valley Authority (TVA) and Appalachian Regional Commission (ARC).

This paragraph ignores the State CDBG Program, the federal government's primary loan or grant program for rural economic development, a program that is administered by states. This lack of acknowledgement of the state role in rural development may be due partly to the absence of a direct, explicit, and substantial involvement of states in federal programs that are perceived as wholly or largely federal rural development programs. Certainly, to the extent that agricultural commodity programs are seen as synonymous with rural development, a view much less widely held now than a decade ago, rural development is largely seen as a direct federal to farm initiative. More relevant to a more contemporary notion of rural development, however, is that the relative absence of a direct state role in the development programs of the Farmers Home Administration and the Economic Development Administration, and to a much lesser extent the Small Business Administration, may bias or cloud the perspective of the national policy community toward states and rural development even though states are central to the utilization of resources for rural development.

The Changing Rural Economy

This section of the report examines the characteristics of the rural economy, the effect of shifts in the national and international economy during the 1970s and 1980s on the rural economy, and the challenges these shifts portend for the 1990s. Generalizing about the rural economy is hazardous because it is composed of several distinct subeconomies, based in large part on location. Manufacturing dominates the South and the East, agriculture dominates the Plains states, and mining is concentrated in the Southwest and in Appalachia. Long-term poverty counties tend to be located in the South. [2]

The Boom of the 1970s

Increasing inflation, low real interest rates, a devalued dollar, high energy prices, and a rapid growth of international markets characterized the national economy in the 1970s. These economic conditions provided advantages for agricultural, manufacturing, and mining employment in rural areas, especially because these three sectors account for 40 percent of rural employment. Between 1970 and 1977, employment in nonmetropolitan areas grew by 24.4 percent, compared to 14.2 percent in metropolitan areas.

Farmers borrowed capital to invest in new equipment, production techniques, and land. Agricultural areas benefitted from increased land values and the expectation that investment in agriculture would continue to be profitable and relatively risk free. Although agricultural employment declined by 100,000 during the 1970s, this contrasted sharply with the loss of one million agricultural jobs in the 1960s.

Increased oil prices and oil exploration led to increased natural resource specialization. Employment in oil and gas grew by more than 5 percent per year in the 1970s and coal mining employment increased moderately. Increases in rural manufacturing employment also helped to outweigh the slight decreases in agricultural employment. The nonmetropolitan share of employment in manufacturing increased from 19 percent in 1969 to 21.1 percent in 1979. The number of manufacturing jobs in nonmetropolitan areas increased by nearly 600,000 during this time, or 15 percent.

As a consequence of these changes rural economic growth during the 1970s was greater than it had been in decades. Rural areas appeared to be catching up to urban areas.

- Poverty decreased in rural areas. The nonmetropolitan poverty population decreased by 12. 6 percent, while poverty in the metropolitan areas increased 10 percent. The nonmetropolitan share of people living in poverty dropped from 39 percent in 1969 to about 34 percent in 1979.

- Unemployment decreased in rural areas. Between 1973 and 1977 the nonmetropolitan unemployment rate was lower than the metropolitan unemployment rate.

- Per capita income increased in rural areas. Between 1969 and 1973 per capita income in nonmetropolitan areas increased by 4.7 percent, and then increased by another 0.8 percent between 1973

and 1979. This increase compared favorably to the increase of 2.2 percent and 1 percent, respectively, in metropolitan areas.

- Population increased in rural areas. The nonmetropolitan population grew by 14.4 percent between 1970 and 1980, and compared to the 10.5 percent population growth of metropolitan areas.

Although rural areas were catching up, at the end of the 1970s poverty rates still remained higher in nonmetropolitan areas than in metropolitan areas, and per capita income still lagged by $866. By the end of the 1970s the rural bloom was clearly fading.

The Problems of the 1980s

A deep recession, rising interest rates, record trade deficits, an overvalued dollar, and the continued dramatic shift of employment from manufacturing to services characterized the national economy in the 1980s. For rural areas, the assets of the 1970s became the liabilities of the 1980s.

Before 1981, expanding export markets absorbed a major portion of the increased agricultural output, but by 1987 farm exports had dropped 13 percent from their 1981 peak. The 1980s also saw lower commodity prices and farm income. The agricultural economy was facing high-interest loans and reduced product demand. Lower world oil prices caused a drop in oil and gas extraction employment, and manufacturing sector employment dropped by over 210,000 between 1979 and 1984.

The rocky performance of the rural economy in the 1980s rekindled the historical disparities between urban and rural areas. By 1985, the rural poverty rate was 18 percent, comparing once again unfavorably to the urban areas 12 percent. The rural unemployment rate, which was lower than that of urban areas throughout most of the 1970s, began in 1980 to exceed the urban unemployment rate, and continued to increase, widening the gap a little more each year (Joint Economic Committee, 1986). By 1984, the rural unemployment rate was 8.4 percent, compared to 6.9 percent in urban areas. Unemployment increased in all the basic rural sectors – agriculture, mining and energy, and manufacturing. Rural per capita income increased only 0.3 percent between 1979 and 1984, compared to a 0.8 percent increase in urban areas.

After the early 1980s the national economy boomed, but not for all economic sectors and not in all geographic areas. While metropolitan areas led the recovery in the 1980s, rural areas for the most part were left behind.

The Challenges of the 1990s

The rural economy did not simply undergo substantial restructuring during the 1970s; mostly it responded favorably to national socioeconomic conditions. Several factors that contributed to population and employment growth in rural areas in the 1970s no longer have an impact (McGranahan, 1986). The interstate highway system has been complete for some time and is no longer contributing to manufacturing and population dispersal to rural areas. The power of labor unions to effect high wages and thus provide rural areas a competitive advantage of low cost labor is waning, particularly as unions shift their attention to job security. The baby boom generation entered adulthood in the 1970s and accounted for much of the population growth of nonmetropolitan areas. Rising commodity prices and a weaker dollar might give rural areas some relief in the immediate future, but they are unlikely to repeat the growth and development that occurred in the 1970s.

A change that does represent an economic restructuring however, is the long-term shift from natural resource-based economies to services: 83 percent of all jobs created in nonmetropolitan areas between 1964 and 1986 were in the service sector. But rural services tend to be consumer, rather than business' services. That is, they are such services provided to households as retailing, (especially food stores, auto dealerships, and gas stations), education, and health. Services in urban areas, such as banking and business services, tend to have a business clientele. Business services employees often are higher skilled and better paid (McGranahan, July 1987, 5).

Although a structural change is taking place in the rural economy, agriculture, mining, and especially manufacturing employment continue to dominate, and rural manufacturing tends to be routine, not complex. Routine manufacturing industries have a relatively low percentage of managerial, technical, and professional jobs and have lower value added than complex manufacturing industries. Examples of routine manufacturing industries are fabricated metals, tobacco, primary metals, stone, clay, and glass, furniture, apparel, textiles, lumber, and leather. Routine industries tend to be at the bottom of their production cycle; that is, their products are in their mature stage of development, and their production is standardized and not dependent on technically–skilled labor.

Complex industries have a relatively high percentage of managerial, technical, and professional jobs and have relatively high value-added. Examples of complex industries are aircraft, electrical machinery, professional equipment, chemicals, petroleum, and printing. Complex industries tend to be at the top of their production cycle; that is, their products are in their early development stages and require labor with a high degree of technical skill.

Complex industries have a better future than routine industries. Employment in complex industries is projected to increase by nearly 18 percent between 1984 and 1995, while employment in routine industries is expected to decrease nearly 3 percent in the same period (McGranahan, July 1987, 17). Rural areas seem to be increasing their share of routine industry, but not their share of complex industry (McGranahan, July 1987, 9). Twenty-eight percent of this country's employment in routine manufacturing was in nonmetropolitan areas in 1984 compared to 23 percent in 1969.

The decline in agriculture and mining employment is expected to continue. As noted above, routine industries face a stagnant demand and increased competition; in 1986 these industries had nearly 12 percent fewer jobs than they had in 1979. While white collar manufacturing jobs increased by 12 percent between 1979 and 1986, production manufacturing jobs decreased by 14 percent – and 74 percent of the manufacturing jobs in nonmetropolitan areas in 1986 were in production. Manufacturing jobs, especially production jobs, are susceptible to business and other macroeconomic fluctuations. Also, rural areas tend to specialize in slow-growth industries that may offer little opportunity for the growth of new businesses (McGranahan, July 1987, 6).

Arguably, the long-term future success of rural areas is related to the extent to which rural economies can develop service industries, expand complex manufacturing employment, and nurture new and small businesses.

The following chapters describe the geographic distribution of State CDBG funds, analyze the kinds of economic development activities funded and the types of businesses assisted, and look at the relationship of the State CDBG program to the changing nature of the rural economy and to the challenges posed by the economic problems of rural areas.

II. ALLOCATING RESOURCES TO RURAL AREAS

This chapter examines the geographical distribution of State CDBG funds to determine the extent to which State CDBG resources were used in rural areas, three different definitions of rural. The first, and most common definition of rural, distinguishes between metropolitan and nonmetropolitan areas. The second definition divides nonmetropolitan counties into six categories based on the level of urban population within a county and whether a county is adjacent to a metropolitan county. Finally, a definition of small community, which includes an incorporated municipality as well as unincorporated places, is used.

Distribution of CDBG Funds and Projects to Rural Areas

Funding Nonmetropolitan Areas

States distributed CDBG funds primarily to nonmetropolitan areas between 1982 and 1986. Nearly 72 percent of the CDBG economic development projects and funds went to nonmetropolitan areas, representing a grant investment in job creation and retention of about $521 million. This rural emphasis is particularly evi[illegible]t given that about 55 percent of the nonentitled population lives in nonn[illegible]politan areas.

States slightly increased the program's focus on nonmetropolitan areas over time. The percentage of projects located in nonmetropolitan areas continually increased from 1983 to 1986, from 65 percent to 75 percent, while the percentage of funds distributed to nonmetropolitan areas increased from 69 percent in 1982 to 73 percent in 1986. Because the average size of the CDBG grant was slightly smaller for nonmetropolitan areas than for metropolitan areas, $224,224 compared to $237,507, the percentage distribution of funds to nonmetropolitan areas was always a bit smaller than the distribution of projects.

Funding Very Rural Areas

The second rural measure is a continuum of counties that ranges from very urban to very rural. This measure divides metropolitan counties into "central" (Urban-2) and "outlying," (Urban-1) while nonmetropolitan counties are divided into one of six groups, based on the size of their urban population and their distance from a metropolitan county, as follows:

1. nonmetropolitan county with an urban population of 20,000 or more and adjacent to a metropolitan area (rural-1 in Figure 1 and other figures);

2. nonmetropolitan county with an urban population of 20,000 or more and nonadjacent to a metropolitan area (rural-2);

3. nonmetropolitan county with an urban population of less than 20,000 and adjacent to a metropolitan area (rural-3);

4. nonmetropolitan county with an urban population of less than 20,000 and nonadjacent to a metropolitan area (rural-4);

5. completely rural county and adjacent to a metropolitan area (rural-5); and

6. completely rural county and nonadjacent to a metropolitan area (rural-6).

States allocated over one-half of their CDBG funds and projects to the four most rural groups of counties, and over one-third to the three most rural groups of counties (Figure 1, N = 3,303).[3] The State CDBG Program became more rural over time. Slightly less than 32 percent of the projects in 1982 and 1983 were located in the three most rural groups of counties, but this increased to about 37 percent in 1985 and 1986. Also, the percentage of projects located in the most urban counties decreased over time from about 24 percent in 1982 to about 15 percent in 1986.

Table 1 further illustrates the extent to which the State CDBG Program serves rural areas. The distribution of State CDBG projects and funds fairly well matches the distribution of nonmetropolitan population, with the least rural county group (rural-1) being the only group of counties substantially under- or over-represented.

Urban to Rural Project Distribution

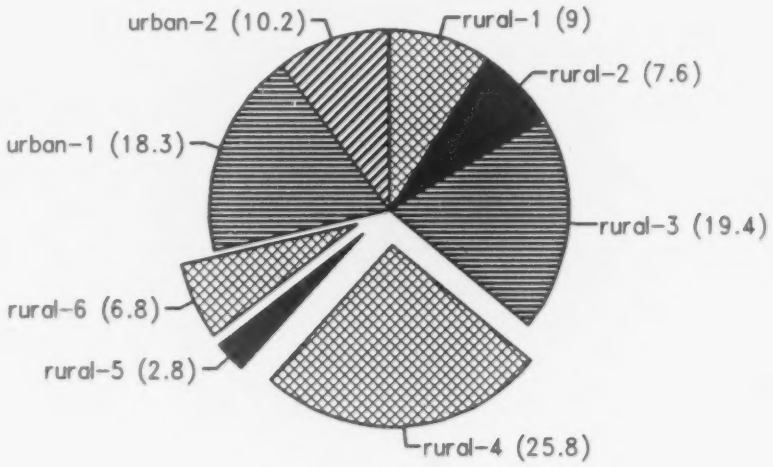


Figure 1

Table 1
Distribution of Nonmetropolitan State
CDBG Projects by Rural County Group
(N = 3,303)

Nonmetro (NM) County	Percentage NM Counties	Percentage NM Population	Percentage Projects
rural-1	6	24	13
rural-2	6	15	11
rural-3	23	24	27
rural-4	32	25	36
rural-5	9	4	4
rural-6	24	8	10

*Percentage of projects does not total 100 because county categories are not mutually exclusive. Also, percentage of nonmetropolitan excludes ungrouped counties.

Funding Very Small Communities

The third definition of rural relates to the population size of the local governments or unincorporated communities receiving CDBG assistance. While it is not true that smaller communities are always more rural than larger communities, the small communities, whether in metropolitan or nonmetropolitan counties, generally have fewer internal resources and are less able to obtain external funds.

Slightly over one-half of all CDBG economic development projects and funds went to localities or communities with populations of 5,000 or less (Figure 2, N = 2,933). Nearly three-quarters of the projects and funds went to localities or communities with populations of 10,000 or less. The states' pronounced funding of small communities remained stable over time: 71 percent of the projects were in localities or communities of 10,000 or less in 1982, and 70 percent in 1986. The percentage of projects located in communities with populations of more than 30,000 dropped from 10 percent in 1982 to 5 percent in 1986.

Rural Economic Base and Development

Nonmetropolitan counties differ in ways other than how rural they are. Their economic bases and economic characteristics also differ. This portion of the chapter looks at the distribution of State CDBG resources to nonmetropolitan counties with different economic bases, using a classification developed by the U.S. Department of Agriculture, called the "Ross-Green" code in rural development literature. According to this code:

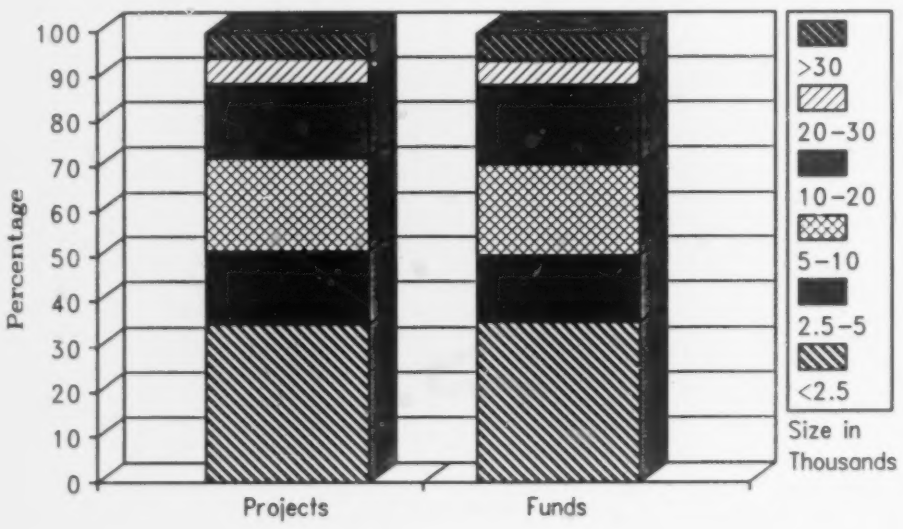

Project and Fund Distribution by Community Size
Percentage
100
90
80
70
60
50
40
30
20
10
0
Projects
Funds
>30
20-30
10-20
5-10
2.5-5
<2.5
Size in Thousands

Figure 2

- In **agricultural** counties, farming contributed a weighted average of 20 percent or more to proprietor income.

- In **manufacturing** counties, manufacturing contributed 30 percent or more of total labor and income.

- In **mining** counties, mining contributed 20 percent or more to labor and proprietor income.

- In **federal lands** counties, 33 percent or more of their total land area is federal land.

- In **government** counties, local, state, and federal government contributed 25 percent or more of total labor and proprietor income.

- In **retirement** counties, a 15 percent or more immigration of people over the age of 60 occurred between occurred 1970 and 1980.

About 42 percent of all nonmetropolitan CDBG economic development projects and 44 percent of the funds were located in manufacturing counties. (Figure 3). Most rural economic development strategies emphasize manufacturing, and manufacturing counties have an economic base on which to expand or recruit new manufacturing industries.

Retirement counties received the next largest percentage of projects and funds, 21 and 19 percent, respectively. Agricultural counties received 16 percent of the projects and funds. Government counties contained 11 percent of all projects and funds. Federal lands counties had 10 percent of the projects and 7 percent of the funds. Mining counties received the least CDBG funding, with 5 percent of the projects and funds.

Table 2 shows that the distribution of State CDBG nonmetropolitan economic development projects and funds resembles the distribution of population among counties of different economic bases.

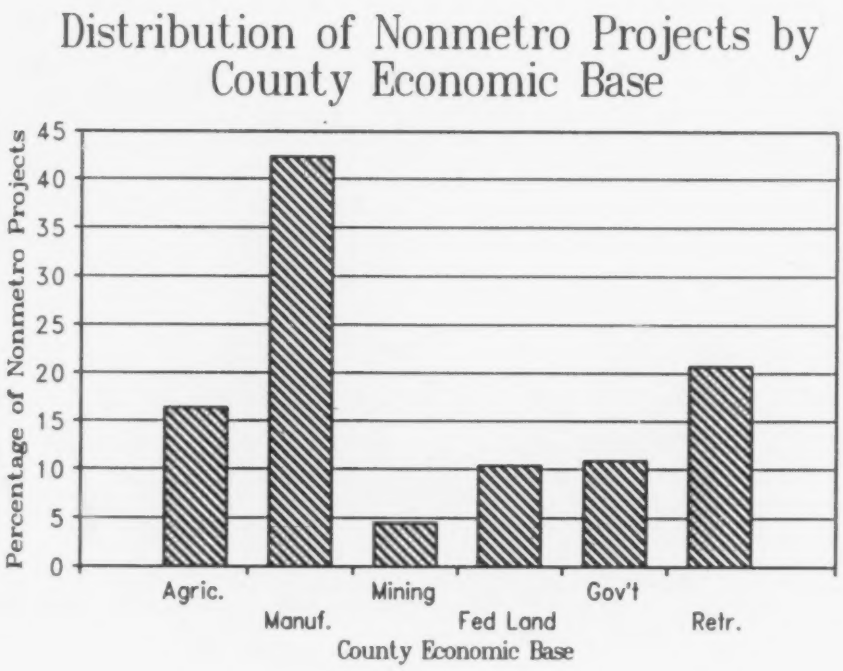

Distribution of Nonmetro Projects by County Economic Base
Percentage of Nonmetro Projects
45
40
35
30
25
20
15
10
5
0
Agric.
Manuf.
Mining
Fed Land
Gov't
Retr.
County Economic Base

Figure 3

Table 2
Distribution of Nonmetropolitan Population and the State CDBG Projects by County Economic Base

County Economic Base	Percentage NM Population	Percentage of Projects*
Agricultural	13	16
Manufacturing	37	42
Mining	6	6
Government	14	11
Public Lands	8	10
Retirement	22	21

* Percentage of projects does not total 100 because county categories are not mutually exclusive. Also, percentage of nonmetropolitan excludes ungrouped counties.

The distribution of CDBG projects among counties of different economic structure did not vary much over time (Figure 4). The largest changes occurred between 1982 and 1983, and probably were the result of 10 new states joining the program in 1983. There was a trend to distribute more projects to mining counties, and slightly fewer to manufacturing counties.

The State CDBG Program: A Significant Economic Development Resource

As already noted, about 72 percent of the state CDBG funds used for economic development were allocated to nonmetropolitan areas. If the assumption is made that the use and allocation of funds between 1982 and 1986 is similar to the data in this report and if nonmetropolitan areas are broadly considered rural, the State CDBG program is the federal government's primary rural economic development loan or grant program, representing the direct expenditure of about $1.25 billion between 1982 and 1989 for job creation and retention in nonmetropolitan areas.

Table 3 compares State CDBG economic development obligations from 1982 through 1986 to obligations for the federal government direct loan and grant programs most typically viewed as rural economic development programs. In the table, "rural" is defined as nonmetropolitan. The table shows that HUD is the federal government's key rural economic development agency and that the State CDBG Program is the federal government's key rural economic development program. The CDBG program is compared only to

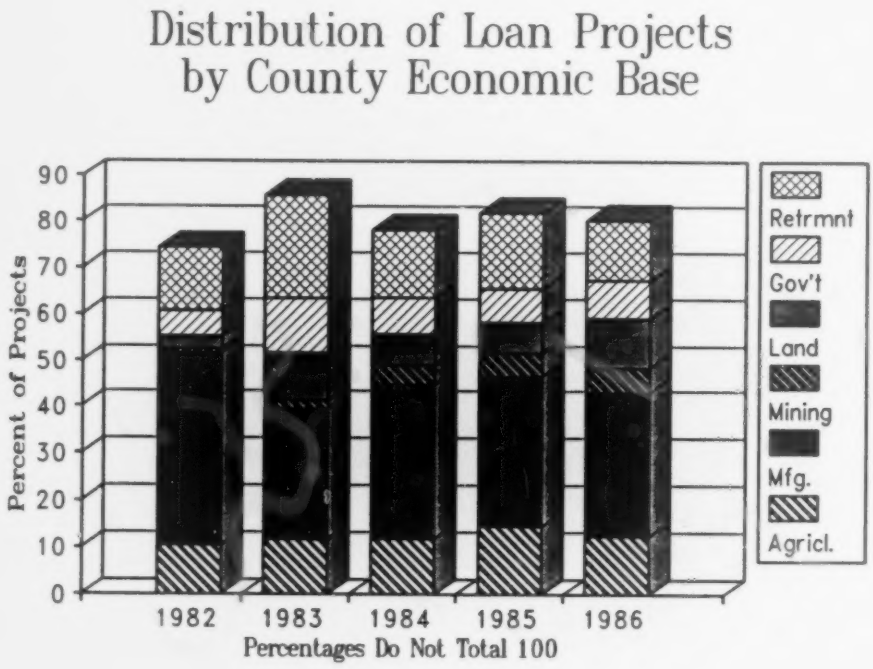

Distribution of Loan Projects
by County Economic Base
Percent of Projects
90
80
70
60
50
40
30
20
10
0
1982
1983
1984
1985
1986
Percentages Do Not Total 100
Retrmnt
Gov't
Land
Mining
Mfg.
Agricl.

Figure 4

loan and grant programs directly used to create or retain jobs and develop businesses, so that similar programs are compared.

Table 3
Federal Obligations of Economic Development Loan and Grant Program in Nonmetropolitan Areas, 1982-1986[4]

Agency/Program	Obligation (millions)
EDA	
Public Works	$457.5
Economic Adjustment	107.2
SBA	
Economic Opportunity Loans	9.9
Minority Enterprise Small Business Investment Corporations (MESBIC)	10.7
HUD	
Urban Development Action Grant	301.2
State CDBG	712.8

III. ASSISTING RURAL ECONOMIC DEVELOPMENT

This chapter has two major purposes. One is to provide an overview of the states' use of the CDBG Program for economic development. This overview first describes the types of economic development activity funded by the states, distinguishing primarily between infrastructure assistance and business loans. It looks at the seven kinds of businesses that received loans: franchises, start-ups, branch plants, expansions, retentions, intrastate relocations, and interstate relocations.[5] It also examines the kinds of industries funded, distinguishing primarily between manufacturing and nonmanufacturing industries, and the size of the businesses funded. Finally, it looks at public and private leveraging of CDBG funds and the cost per planned job.

The second purpose is to determine whether economic development activities funded by the State CDBG Program differed by the extent to which the activity was located in a rural area. This portion of the chapter compares the use of State CDBG funds between metropolitan and nonmetropolitan areas. It tries to determine whether more rural areas used State CDBG economic development resources differently than less rural areas, and whether the economic base or function of nonmetropolitan counties affected the use of the State CDBG Program.

The chapter suggests reasons for the differences, in part by referring to themes in the rural economic development literature. It pays special attention to the role of routine and complex manufacturing industries because of the importance attached to these industry types in the rural development literature. Finally, it reviews State CDBG activity in distressed areas, especially looking at whether State CDBG activity varied with its location in a distressed area.

Types of Economic Development Projects

From 1982 through 1986, states used CDBG funds mostly to provide credit assistance to businesses. Nearly 68 percent of the funds were loans to businesses, with loans to end users accounting for 66 percent and real estate (non-end users) loans accounting for less than 1 percent. The percentage of economic development projects that were business loans increased over time, from 56 percent in 1982 to 78 percent in 1986.

States used about one-third of their CDBG economic development funds from 1982 through 1986 for infrastructure assistance for economic development. They used about 20 percent of the funds to provide infrastructure as-

sistance to a single business, and about 10 percent of the funds to provide infrastructure assistance to two or more businesses.

The average infrastructure assistance project used more CDBG funds than did the average business loan project. The average size of the CDBG grant for business loans was $207,000, smaller than the average size grant for infrastructure assistance to a single business, $224,000, and much smaller than the average size grant for infrastructure for multiple businesses, $291,000. Because of the differential in average grant size, 70 percent of the CDBG projects were business loans, and 27 percent were infrastructure projects.

Differences between Metropolitan and Nonmetropolitan Areas

Slight differences existed between metropolitan and nonmetropolitan areas in the funding of different types of economic development projects. The most significant difference was the relatively larger distribution of infrastructure projects in metropolitan areas. About 27 percent of all economic development projects were infrastructure projects, but this percentage increased to about 31 percent in metropolitan areas and decreased to about 25 percent in nonmetropolitan areas.

The relatively greater use of State CDBG funds by metropolitan areas for infrastructure projects suggests that extending a water or a sewer line to a business may be a more common need in urban fringe or urbanizing areas than in rural areas. The most pressing infrastructure need in rural areas – if there is any pressing economic development need for infrastructure at all – may be the construction or substantial expansion of a treatment facility.

Business loans were relatively more frequent in nonmetropolitan areas than in metropolitan areas.

Contrasts among Rural Counties

In nonmetropolitan areas, the type of economic development activity funded tended to be the same regardless of how rural a county was. For example, relatively little variation existed among the continuum of rural counties in the percentage of CDBG projects that were business loans. The highest percentage of CDBG projects that were business loans, 77 percent, occurred in the most rural group of counties, but the second highest percentage, 74 percent, occurred in the least rural county group (Figure 5). This suggests that business development opportunities that can effectively respond to the

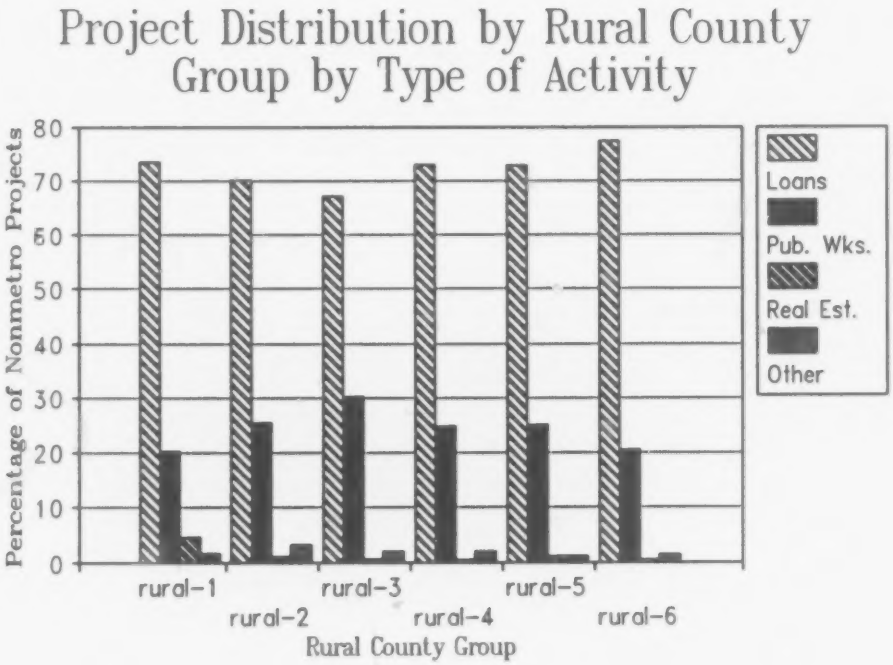

Project Distribution by Rural County Group by Type of Activity
Percentage of Nonmetro Projects
80
70
60
50
40
30
20
10
0
rural-1
rural-2
rural-3
rural-4
rural-5
rural-6
Rural County Group
Loans
Pub. Wks.
Real Est.
Other

Figure 5

availability of below-market financing, or perhaps just the availability of financing, can be found in even the most rural counties.

Rural counties adjacent to metropolitan counties tended to have the highest percentage of infrastructure projects. These counties had much higher population growth rates than did nonadjacent counties. The 1970 to 1980 population growth rates of rural-1, rural-3, and rural-5 counties were 17, 17, and 21 percent, respectively, compared to an average of about 14 percent for nonadjacent counties. This again suggests that rural counties experiencing population growth pressures from adjacent metropolitan areas may need infrastructure investment to obtain business development and subsequent employment growth, and infrastructure investment alone may not help economic development in areas that are far from markets, or are otherwise economically disadvantaged due to the lack of a skilled labor force (Fox, 13-12).

The data illustrated in Figure 5 also suggest that urbanizing rural counties adjacent to metropolitan areas may generate the most opportunity for – or generate the most interest in – real estate, or non-end user economic development activity.

Variations among Rural Economic Bases

Agricultural, mining, and federal lands counties received a substantially higher percentage of economic development projects that were business loans, 81 percent in agricultural and federal land counties and 78 percent in mining counties, than did other counties (Figure 6). At the same time, agricultural, mining, and federal lands counties had a much lower percentage of infrastructure projects, 18, 19, and 16 percent respectively, than did the other counties, which averaged about 28 percent infrastructure projects.

Federal lands, agricultural, and mining counties have very low population densities: 15.4 persons per square mile for federal lands counties, 18.3 for agriculture, and 29.2 for mining. Compared to densities of 66, 47, and 42 for manufacturing, government, and retirement counties, respectively. Agricultural and federal land counties may need infrastructure assistance more for the construction or substantial expansion of treatment facilities or major roads, which would be too cost-ineffective for the CDBG Program, or, more likely, for community-wide public works that could not be funded as economic development under a job creation or retention rationale. Counties with other economic bases, which are more likely to have treatment facility capacity or major roads in place, may need infrastructure assistance to extend lines or for minor road projects, which would be cost-effective.

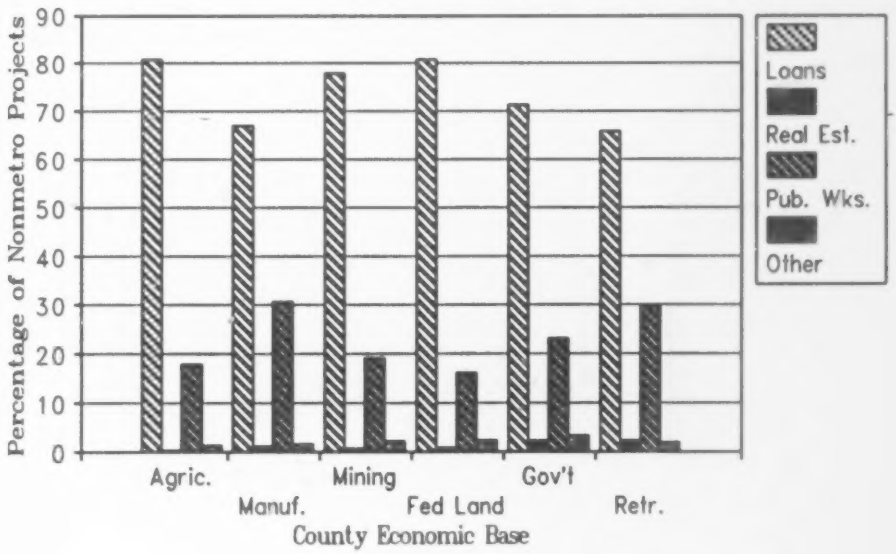

Project Distribution by County
Economic Base by Type of Activity
Percentage of Nonmetro Projects
90
80
70
60
50
40
30
20
10
0
Agric.
Manuf.
Mining
Fed Land
Gov't
Retr.
County Economic Base
Loans
Real Est.
Pub. Wks.
Other

Figure 6

Real estate projects, in which the end users are probably commercial and service businesses, were more likely to be located in counties dominated by a service or transfer economic base. These counties are also rapidly growing counties. Retirement counties, for example, had a population growth rate of 33.5 percent between 1970 and 1980. This would help explain the dominance of real estate projects in these areas, especially if the end users were consumer service businesses.

Business Loans

State CDBG business loans primarily assisted existing and new businesses. About 45 percent of all business loan projects were expansions, and about 25 percent were start-ups. Less than 13 percent of all business loan projects were intrastate or interstate relocations. Branch plants accounted for only 6 percent of the projects, while retentions and franchises comprised 9 percent and 2 percent of the projects, respectively.

The average size of the CDBG grant varied widely depending on the kind of business assisted. Start-ups and expansions had the smallest average grant size, $175,512 and $179,640 respectively, while franchises and branch plants had the largest average grant size, $338,402 and $306,351, respectively. The differences in average grant size made the percentage of CDBG funds going to start-ups and expansions less than their percentage share of projects, as shown in Table 4.

Table 4
Distribution of CDBG Projects and Funds by Type of Business
(N = 2,439)

Type of Business	Percentage of Projects	Percentage of Funds
Franchise	2	3
Start-up	25	22
Branch Plant	6	9
Expansion	45	39
Retention	9	11
Intrastate Relocation	2	3
Interstate Relocation	11	13

Differences between Metropolitan and Nonmetropolitan Areas

Only small differences appeared between metropolitan and nonmetropolitan areas regarding to business loan projects. In the major kind of business most often funded, expansions, the relative distribution between metropolitan and nonmetropolitan areas was nearly identical (Figure 7, N = 420 for metro and 1,288 for nonmetro). The relative distribution of franchises, start-ups, and especially branch plants was higher in nonmetropolitan areas than in metropolitan areas. The data suggest that trying to attract branch plants is a more viable economic development activity in nonmetropolitan areas than in metropolitan areas. On the other hand, pursuing relocations may be a more viable strategy in metropolitan areas than in nonmetropolitan areas.

Contrasts among Rural Counties

Similarities are more striking than differences when the kinds of businesses that received loans are examined relative to the continuum of rural counties. In nearly every county group, expansions were the dominant kind of business activity funded, and start-ups were second most dominant. Nearly always, even in the most rural counties, about 70 percent of the projects funded were start-ups or expansions.

There is one exception to the similarity in the distribution of start-ups and expansions. Completely rural counties adjacent to metropolitan areas had a much higher percentage of start-up projects funded, nearly 42 percent, than any other group of counties. This suggests that these counties may be a fertile ground for start-ups, because they have low land, labor, and other costs, but have or will have fairly good access to a metropolitan market or metropolitan services. The 1970 to 1980 population growth rate of completely rural counties adjacent to metropolitan counties was 20.7 percent, the highest of all six rural county groups. These counties had a much higher increase in median family income between 1969 and 1979 than did other nonmetropolitan counties, 16.9 percent, compared to the nonmetropolitan average of 10.6 percent, although their income level was still lower than the nonmetropolitan average. The notion that being adjacent to metropolitan areas or urban markets is a strong indicator of rural economic growth potential is a prominent theme in the rural development literature, and is a theme that is reinforced by the data in this report.

Relocations in nonmetropolitan areas tended to be more prominent in rural counties not adjacent to metropolitan areas (Figure 8, M = 420, NM = 1,288)

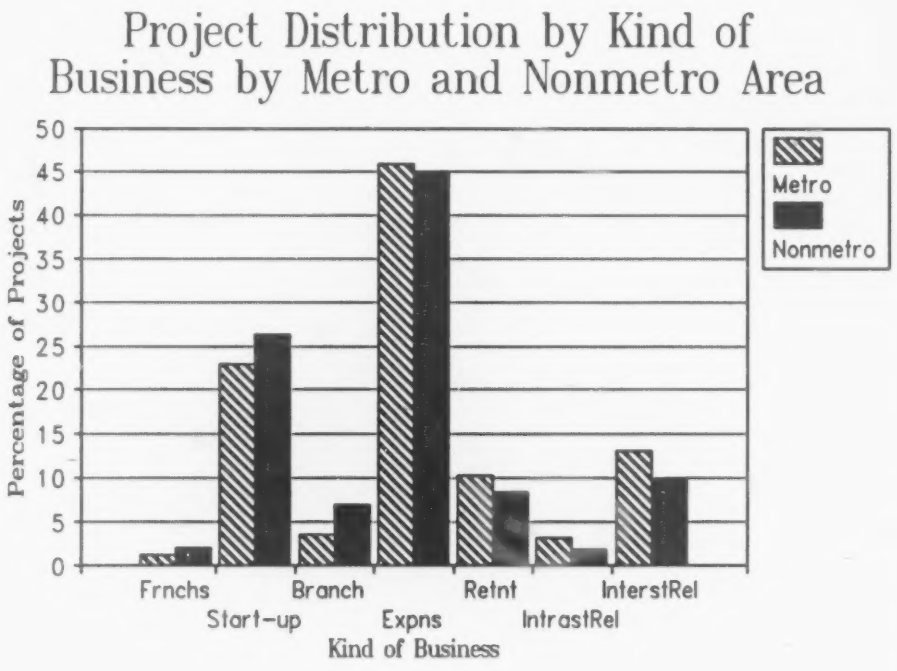

Project Distribution by Kind of Business by Metro and Nonmetro Area
Percentage of Projects
50
45
40
35
30
25
20
15
10
5
0
Frnchs
Start-up
Branch
Expns
Retnt
IntrastRel
InterstRel
Kind of Business
Metro
Nonmetro

Figure 7

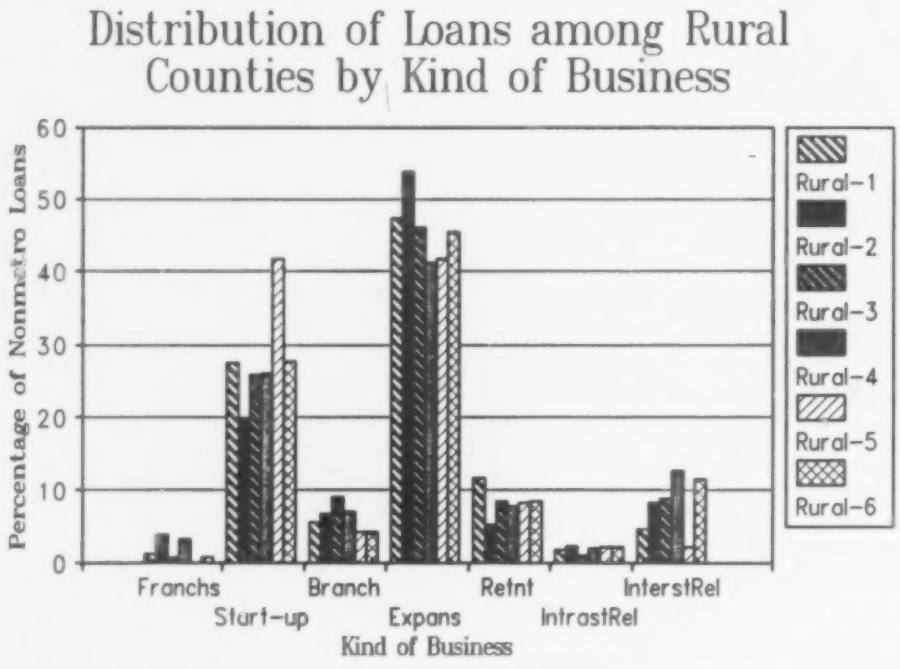

Distribution of Loans among Rural Counties by Kind of Business
Percentage of Nonmetro Loans
60
50
40
30
20
10
0
Franchs
Start-up
Branch
Expans
Retnt
IntrastRel
InterstRel
Kind of Business
Rural-1
Rural-2
Rural-3
Rural-4
Rural-5
Rural-6

Figure 8

suggesting that the firms may be taking advantage of lower production costs. However, with a couple of exceptions, Figure 8 primarily illustrates that the kinds of business opportunities available for economic development programs may be similar regardless of how rural a county is, but the number of opportunities are fewer in more rural counties.

The average size of the CDBG grant varied little by the extent to which the county in which the business was located in was rural. The grant sizes ranged from a $212,606 to $255,381. There was no pattern among the urban to rural continuum of counties. Similarly, there was relatively little variation in grant sizes according to the size of the community where the business was located; the grant sizes ranged from $211,007 to $243,472.

Variations among Rural Economic Base

Expansions dominated each category of county (Figure 9). Manufacturing counties contained a higher percentage of expansion projects, 48 percent, than did the other five categories of counties, where the percentage ranged from 37 percent to 43 percent.

Start-ups remained the second most popular kind of business funded in all categories of counties. The percentage of projects that were start-ups was quite a bit higher in federal lands, mining, and government counties, 32 percent each for mining and federal land and 35 percent for government, than in the other counties, which averaged about 23 percent. Federal lands, mining, and government counties, especially federal lands and mining, had relatively high population growth rates between 1970 and 1980: 34 percent each for federal lands and mining counties and 19 percent for government counties, compared to an average of 15 percent for all nonmetropolitan counties. About 56 percent of start-up businesses were manufacturing firms, and over 98 percent had fewer than 26 employees.

The percentage of business loans that went to branch plants was highest, 11 percent, in manufacturing counties and lowest, 2 percent, in federal lands counties. Over 81 percent of branch plants were manufacturing firms, and branch plants tended to be the largest businesses – about one-third of had more than 100 employees. Manufacturing counties funded the highest percentage of retentions, 11 percent. Over 71 percent of retention businesses were manufacturing firms. Except for the very low percentage of branch plants in federal lands counties, the distribution of branch plants and retentions was relatively similar among nonmetropolitan counties with different economic bases.

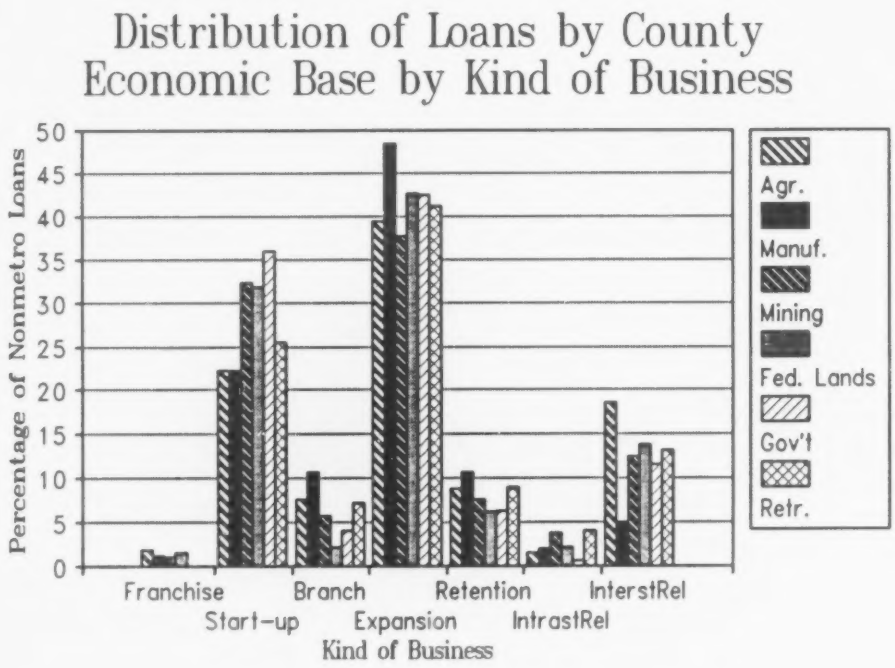

Distribution of Loans by County
Economic Base by Kind of Business
Percentage of Nonmetro Loans
50
45
40
35
30
25
20
15
10
5
0
Franchise
Start-up
Branch
Expansion
Retention
IntrastRel
InterstRel
Kind of Business
Agr.
Manuf.
Mining
Fed. Lands
Gov't
Retr.

Figure 9

With regard to relocations, agricultural and manufacturing counties were on opposite poles. About 20 percent of the projects in agricultural counties were relocations, mostly interstate relocations. Less than 43 percent of interstate relocation businesses were manufacturing firms, and most of the balance were wholesale trade businesses. Most interstate relocations were small; about 70 percent had fewer than 26 employees and nearly three-quarters had 50 or fewer employees. Manufacturing counties and the lowest percentage of relocations, 7 percent.

Size of Businesses Funded

Over two-thirds of the assisted businesses had fewer than 26 employees, and nearly 87 percent had 100 or fewer employees. Less than 3 percent of loans involved businesses with over 500 employees. The information on the size of businesses funded is consistent with the relatively substantial funding of start-ups: nearly all start-ups had fewer than 26 employees.

The emphasis placed on small business remained relatively stable over time. In 1982 about 80 percent of the loans involved businesses with 50 or fewer employees; in 1986 this percentage was 74, the lowest in the five years covered by the study. The percentage of very large businesses assisted, i.e., those with more than 500 employees, gradually increased from less than 1 percent in 1983 to 3 percent in 1986.

The average CDBG grant was smaller for smaller businesses. Businesses with fewer than 26 employees comprised about 69 percent of all projects, but obtained only 55 percent of the CDBG funds. Businesses with more than 100 employees represented only about 13 percent of the projects, but received over 23 percent of the funds.

Differences between Metropolitan and Nonmetropolitan Areas

A higher percentage of the businesses assisted in nonmetropolitan areas than in metropolitan areas had 26 or fewer employees. Businesses assisted in nonmetropolitan areas were somewhat similar to businesses assisted in metropolitan areas in the middle range of business size, but more very small businesses and more very large businesses, were funded in nonmetropolitan areas than in metropolitan areas. (Figure 10, N = 959). Seventy-one percent of nonmetropolitan businesses funded had fewer than 26 employees, compared to 62 percent for metropolitan businesses. On the other hand, 3 percent of nonmetropolitan businesses had more than 500 employees, compared to less than 1 percent of metropolitan businesses.

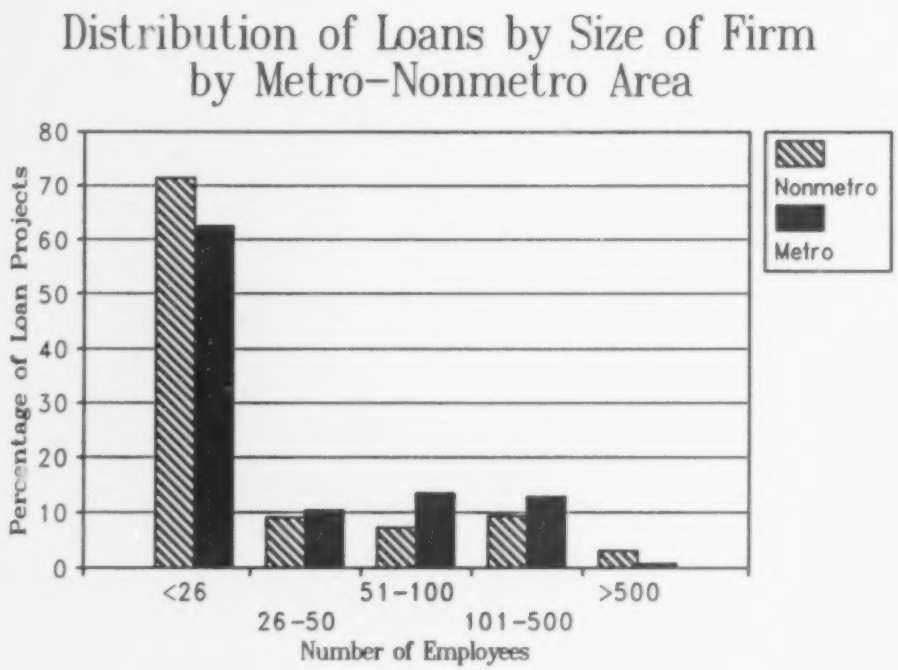

Distribution of Loans by Size of Firm
by Metro-Nonmetro Area
Percentage of Loan Projects
80
70
60
50
40
30
20
10
0
<26
26-50
51-100
101-500
>500
Number of Employees
Nonmetro
Metro

Figure 10

Contrasts among Rural Counties

Firms with fewer than 26 employees, what might be called "very small businesses," were more dominant in the most rural counties (Figure 11). In the three most rural groups of counties 78 percent of the loans went to very small businesses, compared to 65 percent in the three least rural groups of counties.

The extent to which the CDBG Program funded start-ups or very small businesses may be somewhat surprising. Rural economic development specialists have said that slow-growth industries, which tend to be concentrated in nonmetropolitan areas, offer little opportunity for new and expanding businesses, and that rural growth must rely on relocations and branch plants (McGranahan, July 1987, 2-8). The data in this report lend more credence to the view that new or very small businesses are important to and viable in a rural economy.[6]

Manufacturing and Nonmanufacturing Industries

State CDBG loans assisted primarily manufacturing businesses. About 68 percent of the loans went to manufacturing industries. The percentage of loans to manufacturing industries increased over time, from 57 percent in 1982 to 76 percent in 1986, although the increase was not continuous.

Branch plants were the kinds of business that were most dominantly manufacturing: 81 percent of the branch plant loans went to manufacturing industries. About 56 percent of the start-ups were manufacturing industries, in contrast to the majority of start-ups in rural areas, which are in retail and consumer services (Popovich, 1988, 4).

Twelve percent of the businesses assisted by loans were in wholesale trade, and another 7 percent were in services. Businesses in mining; construction; transportation, communication, and utilities; wholesale trade; and finance, insurance, and real estate each received 3 percent or less of the loans.

Because the average-size CDBG grant was much larger for manufacturing firms than for nonmanufacturing firms, nearly 80 percent of State CDBG loan funds went to manufacturing firms, although these firms represented only 68 percent of the loan projects.

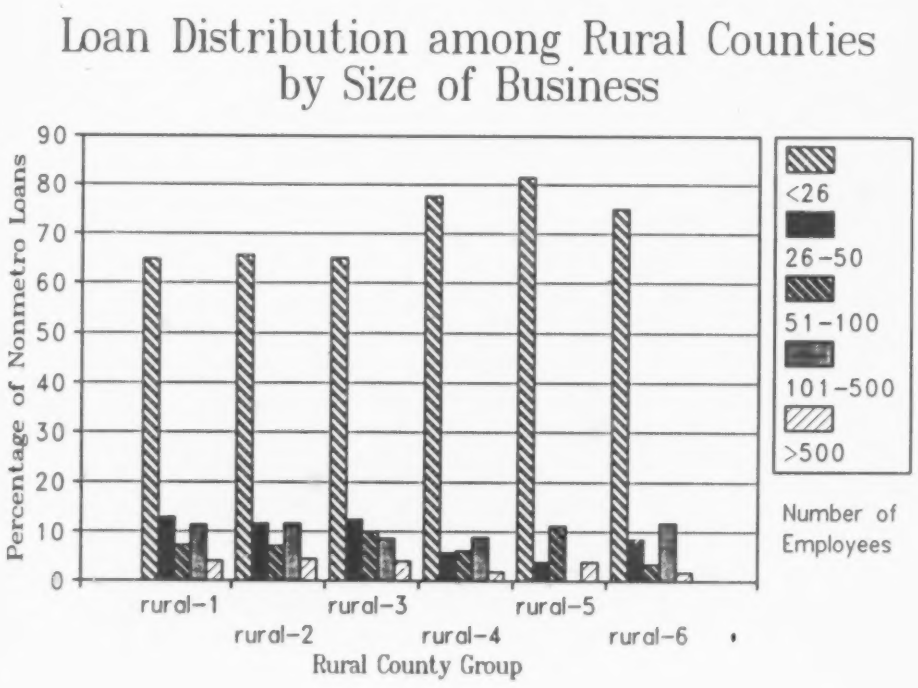

Loan Distribution among Rural Counties
by Size of Business
Percentage of Nonmetro Loans
90
80
70
60
50
40
30
20
10
0
rural-1
rural-2
rural-3
rural-4
rural-5
rural-6
Rural County Group
<26
26-50
51-100
101-500
>500
Number of
Employees

Figure 11

Differences between Metropolitan and Nonmetropolitan Areas

Seventy percent of the businesses that received loan assistance were manufacturing industries in both metropolitan and nonmetropolitan areas. Metropolitan areas had a relatively larger share of projects that assisted businesses in the finance, insurance, and real estate industry, while nonmetropolitan areas had a relatively larger share of projects that assisted businesses in the mining and wholesale trade industries. Little difference existed between metropolitan and nonmetropolitan areas in the share of projects that assisted businesses in retail trade and services. However, within the services industry nonmetropolitan projects focused on the hotel industry, while metropolitan projects focused on business services. Fifteen percent of all loans in metropolitan areas went to businesses in the finance, insurance, and real estate industry and the business services industry, compared to less than 3 percent for nonmetropolitan areas (Figure 12). (Appendix C lists the industry shares of business loan projects.)

Some relatively large differences existed between metropolitan and nonmetropolitan areas in the kinds of industries that received loan assistance. Relatively more business loans in nonmetropolitan areas than in metropolitan areas were made to businesses in apparel and other textile products, lumber and wood products, chemicals and allied products, and transportation equipment. On the other hand, loans to businesses in paper and allied products, rubber and miscellaneous products, and instruments and related products industries were relatively more common in metropolitan areas than in nonmetropolitan areas.

Shifting the analysis from the funding of projects to the funding of planned job creation and retention shows that the emphasis given to manufacturing employment in the State CDBG Program is much more significant than manufacturing's actual share of total employment. Planned manufacturing jobs accounted for 82 percent of all planned jobs in metropolitan areas, 20,016 (N = 398), while planned manufacturing jobs accounted for 84 percent of all planned jobs in nonmetropolitan areas, 56,319 (N = 1,051). Thus, in terms of employment, both metropolitan and nonmetropolitan areas emphasized manufacturing industries about equally. Although in 1977 manufacturing's share of total nonfarm wage and salary employment was nearly equal in metropolitan and nonmetropolitan areas, 20 percent in metropolitan areas and 22 percent in nonmetropolitan areas, by 1988 the difference had grown so that manufacturing's share of total employment was 18 percent in metropolitan areas and 23 percent in nonmetropolitan areas (Brown and Deavers, 1-18 and DeAre and Kalbacher, 22).

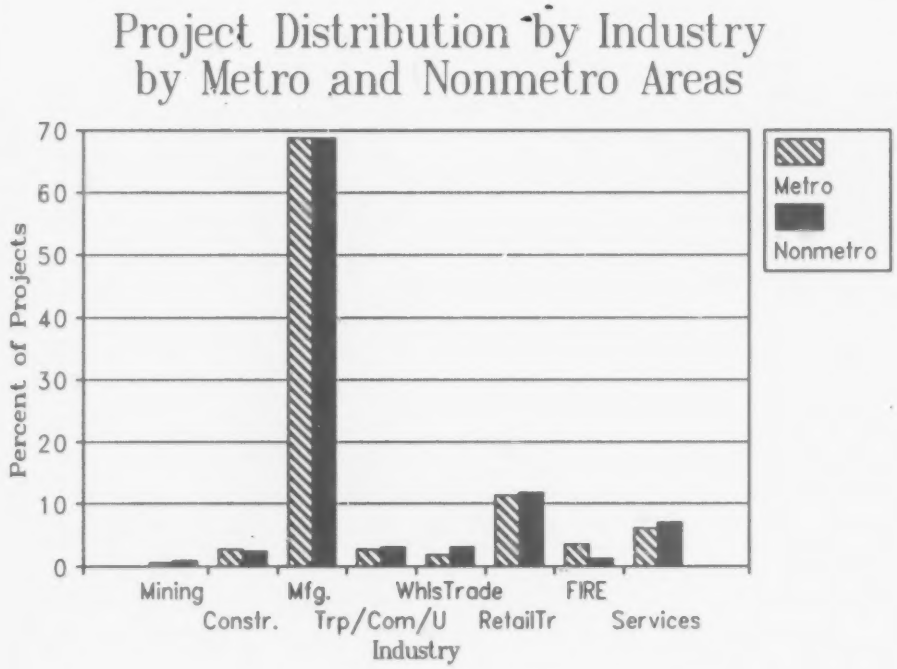

Project Distribution by Industry
by Metro and Nonmetro Areas
Percent of Projects
70
60
50
40
30
20
10
0
Metro
Nonmetro
Mining
Constr.
Mfg.
Trp/Com/U
WhlsTrade
RetailTr
FIRE
Services
Industry

Figure 12

The average number of planned jobs per manufacturing industry project was slightly larger in nonmetropolitan areas than in metropolitan areas, 77 compared to 72.[7] However, for nonmanufacturing industry projects the opposite was true. Metropolitan areas has 36 planned jobs per nonmanufacturing project, compared to 33 in nonmetropolitan areas.

A much lower percentage of planned jobs in metropolitan areas were for low- and moderate-income persons in the average manufacturing industry project than in the average nonmanufacturing industry project: 60 percent compared to 81 percent. The opposite held true for nonmetropolitan areas, where the percentage of planned jobs that were for low- and moderate-income persons was higher for manufacturing than nonmanufacturing industries, 81 percent compared to 76 percent.

The percentage of business loans to manufacturing industries was somewhat similar among nonmetropolitan counties (Figure 13), ranging from 65 percent to 74 percent.

There is some controversy over whether rural service sector employment is producing higher wages and better jobs than those lost in manufacturing, but it is clear that CDBG-assisted jobs were rarely in the service sector. Only 7 percent of the nonmetropolitan area loans went to businesses in the service sector, although in 1980 service jobs comprised 70 percent of all employment in metropolitan areas and 60 percent in nonmetropolitan areas (McGranahan et al 58). Manufacturing firms are by far the predominant target of State CDBG loans, although the percentage of nonmetropolitan workers employed in the manufacturing sector decreased from 24 percent to 20 percent between 1969 and 1984, and 83 percent of all nonfarm wage and salary jobs created in rural areas were in the service sector betweem 1969 and 1984 (Brown and Deavers, 1-4), in contrast to the 25 percent increase in manufacturing jobs (Bloomquist, 1987, 3-3).

Economic development has traditionally focused on manufacturing industries based on the theory that they have a greater effect on local employment and growth than do nonmanufacturing businesses. Manufacturing firms presumably could increase local incomes by enlarging the economic, or export, base of a locality or thereby generating additional employment and income to the locality or region by their secondary and tertiary effect on other businesses, such as commercial, retail, service, and homebuilding activities.

> Recent research indicates that this presumption may not apply to rural areas. "The types of manufacturers attracted to rural areas are those which require large supplies of relatively low-

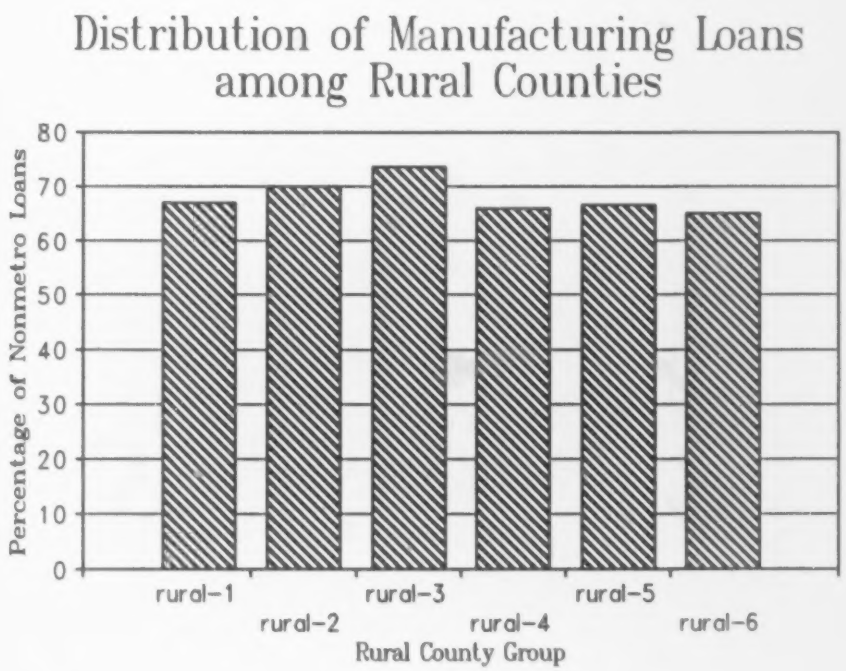

Distribution of Manufacturing Loans among Rural Counties
Percentage of Nonmetro Loans
80
70
60
50
40
30
20
10
0
rural-1
rural-2
rural-3
rural-4
rural-5
rural-6
Rural County Group

Figure 13

> skilled and hard working labor and which have weak backward and forward linkages. Firms with strong attachments to markets and suppliers require proximity to population and employment centers and generally do not select rural areas. If it is primarily firms with weak forward and backward linkages that can relocate to or prosper in rural areas, it is unlikely that UDAG grants which successfully result in investment in distressed rural communities will ever generate much local economic growth, through the attraction or expansion of forward or backward linked industries." (Howland and Miller, May 1988, 13).

During the 1980s, the rural counties that lost population usually experienced decreases in manufacturing employment, but manufacturing employment usually increased in the rural counties with population growth. Thus, at the local level the association of population growth and manufacturing employment growth may be one reason why local economic development efforts may still be closely tied to manufacturing (Bluestone and Wang, 10). The reliance on a manufacturing emphasis in rural economic development is perhaps more understandable given that 40 percent of the nonmetropolitan population lives in manufacturing counties.

Variations among Economic Base

Projects assisting manufacturing industries were much more dominant in manufacturing counties, where 77 percent of loan projects assisted manufacturing businesses (Figure 14). Mining and federal lands counties had the lowest relative share of projects assisting manufacturing businesses, 54 and 56 percent, respectively. Federal lands counties are the sparsest with, 15.4 persons per square mile, of all nonmetropolitan counties. Mining counties have the lowest percentage of income derived from manufacturing of any of the county economic classes, 7.9 percent compared to the nonmetropolitan average of 20.5 percent (Bender et al., 28). Both of these facts help explain the relatively low percentage share of manufacturing projects in these counties.

Assisting Routine and Complex Manufacturing Industries

The distribution of loans between routine and complex industries was similar in metropolitan and nonmetropolitan areas.[8] In nonmetropolitan areas, about 43 percent of all loans went to routine industries, and about 27 percent went to complex industries. The breakdown in metropolitan areas was similar: 42 percent of the loans went to businesses in routine industries, 26 percent to complex industries. The differences between metropolitan and

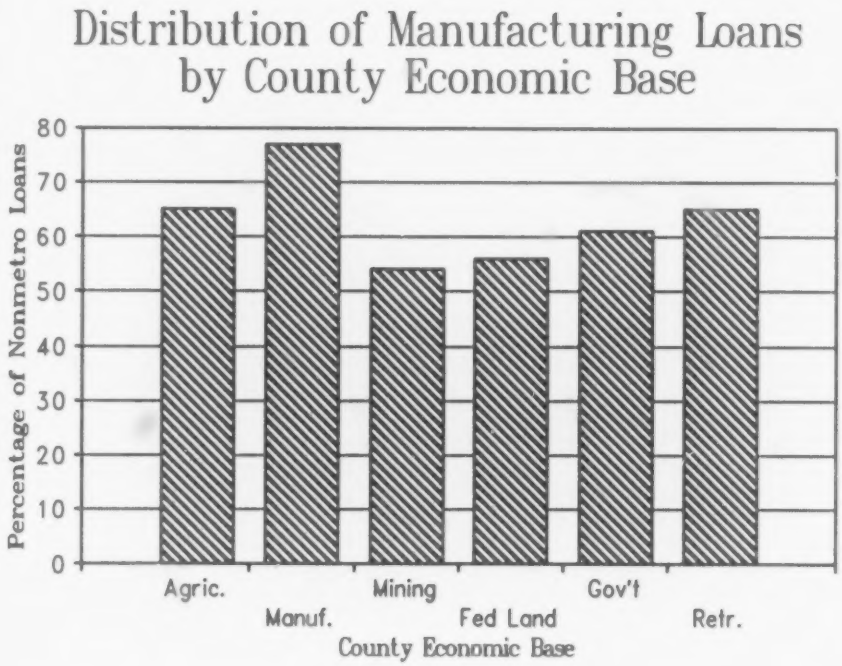

Distribution of Manufacturing Loans
by County Economic Base
Percentage of Nonmetro Loans
80
70
60
50
40
30
20
10
0
Agric.
Manuf.
Mining
Fed Land
Gov't
Retr.
County Economic Base

Figure 14

nonmetropolitan areas widen slightly when planned jobs in manufacturing are considered (Figure 15), although a greater proportion of jobs in routine industries were LMI jobs than in complex industries. (Figure 16.)

In metropolitan areas, the ratio of CDBG-assisted planned jobs in routine industries to planned jobs in complex industries was 1.63. This is much higher than the actual ratio for metropolitan employment in 1986, which was .85. For nonmetropolitan areas the CDBG-assisted planned job ratio between routine and complex manufacturing was 1.94. This is somewhat lower than the actual 1986 nonmetropolitan employment ratio of 2.33. Although CDBG-assisted manufacturing employment was composed primarily of routine jobs, the concentration of routine jobs was slightly less than the actual concentration of routine employment in nonmetropolitan areas.

Three routine industries accounted for nearly one-third of all planned manufacturing jobs in nonmetropolitan areas: food and kindred products and furniture and fixtures, 11 percent each; and apparel and other textile products, 10 percent. Two complex industries, industrial and commercial machinery and electronic and other electrical equipment, had a significant percentage of planned jobs, 19 and 9 percent, respectively.

In metropolitan areas, the industrial and commercial machinery industry also garnered the largest share of planned jobs, 22 percent. No other industry captured a double-digit share of planned jobs in metropolitan areas. Food and kindred products, furniture and fixtures, rubber and miscellaneous plastic products, and fabricated metal products each had about 8 percent of all planned manufacturing jobs in metropolitan areas.

The planned number of jobs per project in nonmetropolitan areas was higher for complex manufacturing industries than for routine manufacturing industries. Complex industries in metropolitan areas had 94 planned jobs per the average project, compared to 72 for routine industries. In metropolitan areas, the average number of planned jobs per project in complex industries was 88, compared to 65 in routine industries. The size of the average manufacturing project as measured by planned employment was higher for complex industries than for routine industries in both metropolitan and nonmetropolitan areas, but both routine and complex manufacturing projects were smaller in metropolitan areas than in nonmetropolitan areas.

As noted earlier in this report, employment in routine industries is projected to decrease by nearly 3 percent between 1984 and 1995, while employment in complex industries is expected to increase by nearly 12 percent (McGranahan, July 1987, 2-17). Between 1979 and 1986 the national growth rate for routine

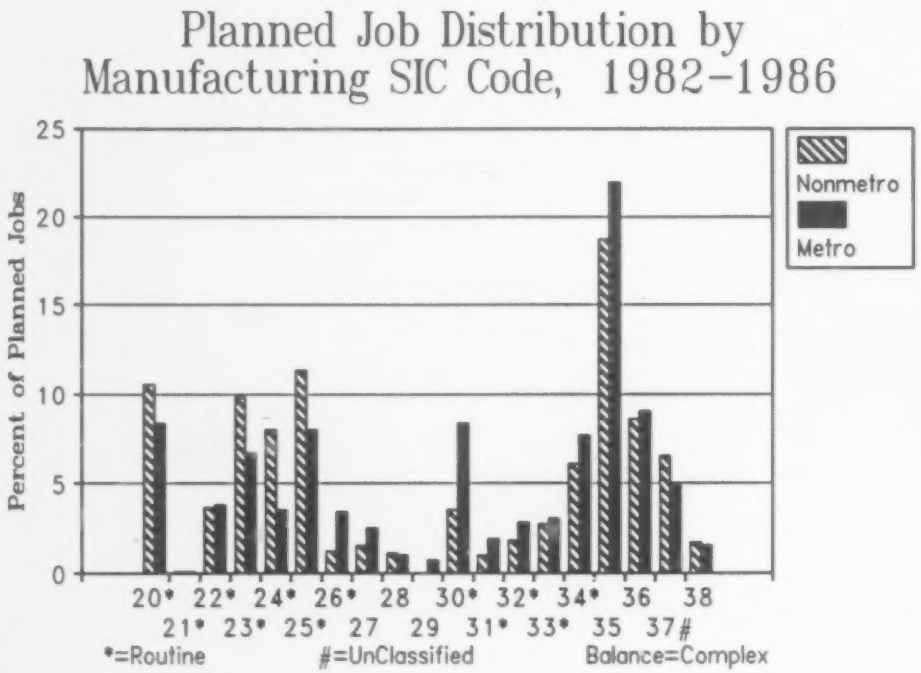

Planned Job Distribution by
Manufacturing SIC Code, 1982-1986
Percent of Planned Jobs
25
20
15
10
5
0
Nonmetro
Metro
20* 22* 24* 26* 28 30* 32* 34* 36 38
21* 23* 25* 27 29 31* 33* 35 37#
*=Routine
#=UnClassified
Balance=Complex

Figure 15

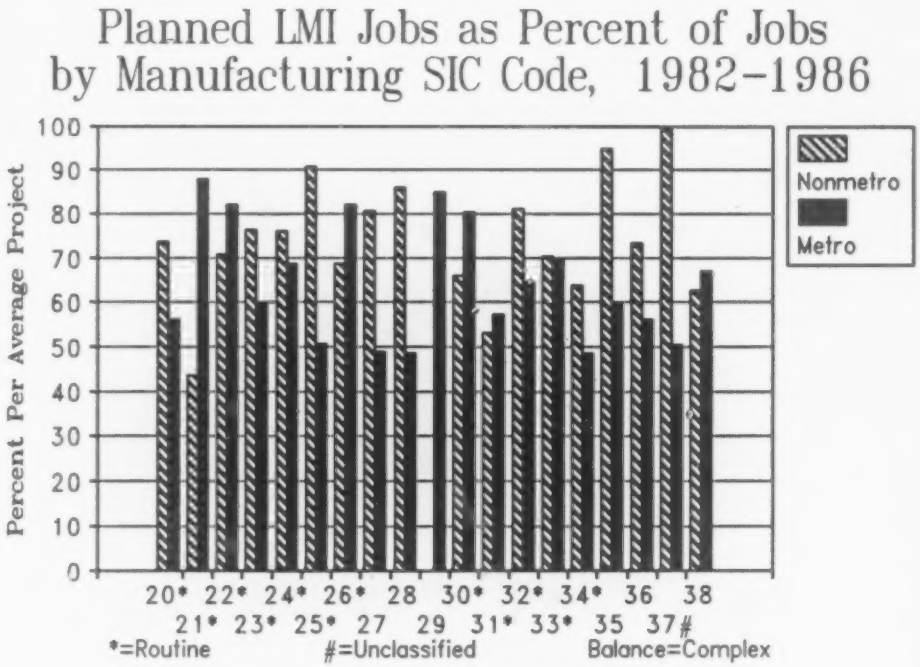

Planned LMI Jobs as Percent of Jobs
by Manufacturing SIC Code, 1982-1986
Percent Per Average Project
100
90
80
70
60
50
40
30
20
10
0
20* 22* 24* 26* 28 30* 32* 34* 36 38
21* 23* 25* 27 29 31* 33* 35 37#
*=Routine
#=Unclassified
Balance=Complex
Nonmetro
Metro

Figure 16

manufacturing employment was -11.7 percent (McGranahan, RDP, June 1988, 10). Yet, the resources of the State CDBG Program were used to promote job creation and retention largely in routine manufacturing industries in both metropolitan and nonmetropolitan areas. The data in this report suggest that CDBG assistance may be difficult to use for complex manufacturing industries or for nonmanufacturing businesses, or that these businesses rarely seek, need, or qualify for financial assistance.

Leveraging

The average grant size indicates the amount of CDBG dollars a business releases. Private funds and often other public funds are invariably added to the package of assistance. The extent to which other funds are added to the amount of the CDBG funds is referred to as the leveraged amount.

In the five-year study period private leveraging occurred in 2,231 projects, with private bank financing in 1,426 projects and owner equity in 1,317 projects. Public leveraging occurred in 926 projects. Federal programs were the most common source of public leveraging, contributing to 308 projects, while state programs were second, contributing to 240 projects.

The scale of leveraging was large. The amount of CDBG funds involved in the economic development projects in this report for which there is information on leveraging is $621 million (N = 2,838). Private leveraging added $2.862 billion, while public leveraging added another $607 million. Thus, one dollar of CDBG funds leveraged $4.61 in private funds and $0.98 in public funds.

Leveraging varied substantially according to the type of economic development activity. The average amount of public and private leveraging was much higher for infrastructure projects than for business loans. Infrastructure projects for a single business had the highest total leveraging, with an average of $10.50 matching every CDBG dollar, with private leveraging of $9.00 per project. Infrastructure projects for multiple businesses, had a total leveraging of $4.21.

Total leveraging for the average business loan project was $4.59. The average amount of private leveraging for business loans was $3.79. The average percentage of public funds in a business loan project continually increased from 13 percent in 1982 to 19 percent in 1986. Table 5 shows that over time a the percentage of public funds put into business loan projects increased.

Table 5
Leveraging By Year for Business Loan Projects

Year	Private Leverage	Public Leverage	Public Leverage as % of Total Loan
1982	$3.01	$.045	13
1983	2.81	.53	16
1984	3.82	.76	17
1985	4.48	.98	18
1986	3.72	.88	19

Differences between Metropolitan and Nonmetropolitan Areas

Total leveraging was substantially higher in metropolitan areas than in nonmetropolitan areas, $6.87 and $5.08, respectively, for each State CDBG dollar. This difference was largely due to the difference in private leveraging.

The differences in leveraging remained when only business loans are examined. The total amount of leveraging in metropolitan areas for business loans averaged $5.22, compared to $4.37 for nonmetropolitan areas. Both private leveraging and public leveraging were less in nonmetropolitan areas, $4.30 compared to $3.61 for private leveraging, and $0.92 compared to $0.76 for public leveraging. In metropolitan areas, CDBG funds comprised 16 percent of total project costs for business loan projects, compared to 19 percent for nonmetropolitan areas. The extent of public leveraging in nonmetropolitan business loan projects is much lower than the 31 percent found in a study of rural UDAG projects, while CDBG's share of total project cost is higher than the 13 percent found for rural UDAG projects (Howland and Miller, Job Creation May 1988, 23).

Contrasts among Rural Counties

Although the type of economic activity funded in nonmetropolitan areas did not vary substantially based on the extent to which a county was rural, variations in leveraging did occur. The lowest total leveraging occurred in the most rural counties, $3.01 for every CDBG dollar. Also, public leveraging was very low in the three most rural groups of counties, averaging $0.83. Clearly, the most rural counties may not have the public funds or access to state and federal funds that the less rural counties have or they may not have the political will to use public funds for business loans.

A similar pattern holds when examining leveraging solely for business loan projects. The lowest amount of total, public, and private leveraging, $2.60, $0.55, and $2.05, respectively, was in the most rural county group. The most rural county group was especially disadvantaged in its very low level of private leveraging, suggesting that businesses or entrepreneurs in very rural counties may have a difficult time obtaining private financing or contributing their own equity. Also, nonmetropolitan counties nonadjacent to metropolitan counties may have more difficulty generating private leveraging than nonmetropolitan counties adjacent to metropolitan counties (Figure 17).

CDBG Cost Per Planned Job

The average CDBG cost per planned job created or retained varied substantially with the type of economic development activity funded. The average CDBG cost per job was between $3,426 and $3,923 for various infrastructure projects, while it was about $5,337 for business loans, and a relatively high $6,730 for real estate projects. These disparities decreased when looking at the cost per job for low-and moderate-income persons. Therefore, a higher proportion of planned jobs in real estate projects than in business loan projects were for lower- income persons, and a higher percentage of planned jobs in business loan projects than in infrastructure projects were for lower-income persons.

Variations also existed in the average CDBG job cost among the different kinds of business loans. The average CDBG total job cost was lowest in retentions, $4,702, and highest in start-ups, $6,158. The average CDBG total job costs for all other kinds of business loan projects were fairly close to one another, ranging from $4,921 to $5,663.

The average CDBG job cost for low- income jobs for all business loans was $8,183. Start-ups still had the highest cost, $8,447, but the average cost per LMI job for expansions and intrastate relocations jumped dramatically to $8,198 for expansions and to $8,005 for intrastate relocations. Clearly, a much lower percentage of created or retained jobs in expansions and intrastate relocations were jobs for lower- income persons than in the other kinds of businesses. A possible explanation for this is that states may be requested by local officials or businesses to assist businesses that want to expand or relocate within the state. In response, the state may negotiate with the business and local officials to ensure that the LMI national objective would be met if CDBG funds are provided.

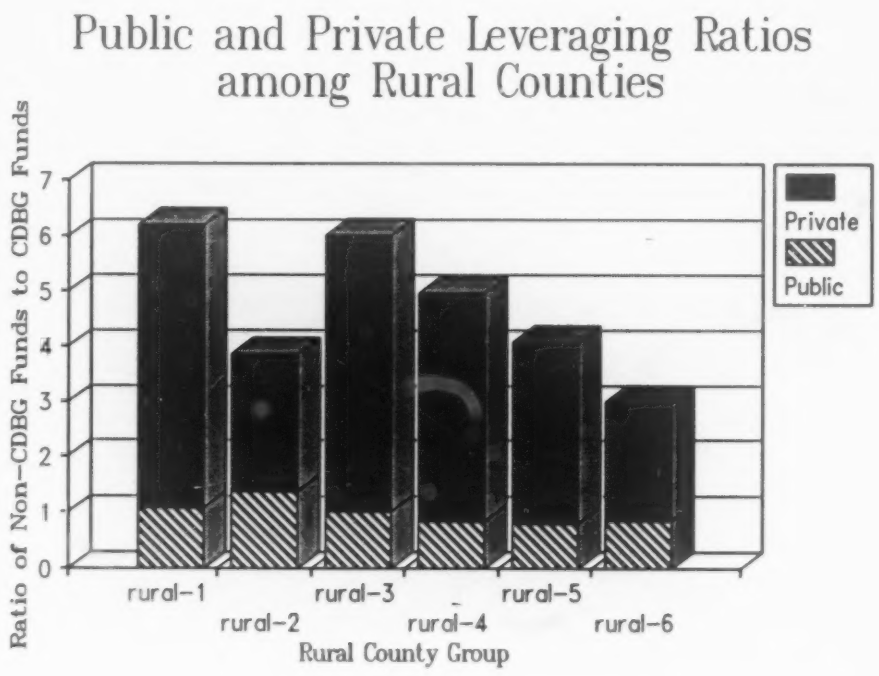

Public and Private Leveraging Ratios
among Rural Counties
Ratio of Non-CDBG Funds to CDBG Funds
0
1
2
3
4
5
6
7
Private
Public
rural-1
rural-2
rural-3
rural-4
rural-5
rural-6
Rural County Group

Figure 17

Differences between Metropolitan and Nonmetropolitan Areas

The metropolitan average CDBG job cost was lower than the nonmetropolitan average CDBG job cost, $4,488 compared to $5,010. For LMI jobs, the costs were $7,431 and $7,665, respectively.

Contrasts among Rural Counties

The average CDBG cost per planned job tended to be higher for the more rural counties. The most rural county group had the highest average CDBG job cost, $6,342, an amount much higher than that of any other county group (Figure 18, N = 2,785 for jobs and 2,240 for LMI jobs). A similar pattern holds for the average CDBG job cost for lower- income persons. The average CDBG cost per LMI job for all projects was $7,589, and the two most rural groups of counties had the highest averages, $8,901 for the most rural, and $8,443 for the second most rural.

The cost of creating or retaining a job may always be higher in the most rural counties, because of the very small size of most assisted businesses in the most rural areas. This finding coincides with a study of the rural Urban Development Action Grant Program that found that the cost per job was higher in more remote rural projects (Howland and Miller, Job Creation, May 1988).

Socioeconomic Characteristics of Funded Counties

States are not required to target their CDBG funds to areas with high poverty or unemployment rates, or any other form of distress, although many states do use measures of local distress as a scoring factor in rating applications. However, in 1983 and 1984, after one or two years of experience in the program, many states reduced the weight they gave to measures of local distress in their rating and ranking of applicants and increased the weight they gave to measures of project impact. This was partly because of defaults, bankruptcies, inability to meet job target requirements, and other problems they had with projects in distressed areas.

Nearly all State CDBG funds are used to meet the national objective of benefitting low- and moderate-income people. Nearly every nonmetropolitan county has a significant percentage of low- and moderate-income people, and some distressed areas or poor communities. In fact, it is likely that economic development funds are less targeted than other CDBG funds because of the need for bottom-line success of the assisted firm, and early state experience

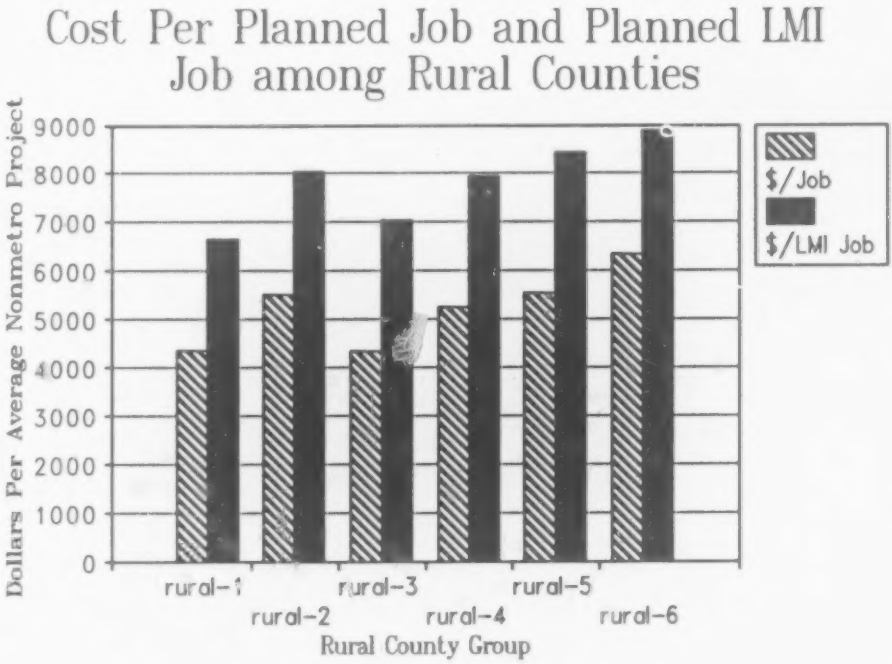

Cost Per Planned Job and Planned LMI Job among Rural Counties
Dollars Per Average Nonmetro Project
9000
8000
7000
6000
5000
4000
3000
2000
1000
0
$/Job
$/LMI Job
rural-1
rural-2
rural-3
rural-4
rural-5
rural-6
Rural County Group

Figure 18

with the CDBG Program anecdotally suggests that successful business projects may more likely be located in a nondistressed area. State CDBG housing and public facilities funds, which focus on governments and poor owner-occupants of housing, are more likely to be distributed to distressed areas.

This section of the report examines the socioeconomic characteristics of counties with CDBG projects using measures of poverty, per capita income, unemployment, and population change.

Poverty

In the aggregate, states tended to fund projects in counties that are slightly poorer, as measured by 1979 poverty rates, than the national average. In each of the years 1982 through 1986, the average poverty rate in counties receiving CDBG funds was higher than the national average poverty rate, by 7 percent in 1982, 11 percent in 1983, 16 percent in 1984 and 1985, and 12 percent in 1986. Historically, poverty rates in nonmetropolitan areas have been higher than poverty rates in metropolitan areas.

When the average poverty rate of CDBG-funded nonmetropolitan counties is compared with the national average poverty rate of nonmetropolitan counties, states tended to fund counties with lower poverty rates. For example, 47 percent of all nonmetropolitan counties had poverty rates greater than 16 percent, but only 37 percent of the counties with CDBG projects had poverty rates greater than 16 percent. Conversely, although 32 percent of all nonmetropolitan counties had poverty rates less than 12.7 percent, 45 percent of all CDBG nonmetropolitan projects were located in these counties.

Another way of measuring poverty is by using the U.S. Department of Agriculture's designation of persistent poverty counties. These are counties that have ranked in the lowest per capita income quintile in 1950, 1969, and 1979. Ten percent of all nonmetropolitan counties are persistent poverty counties, but their share of nonmetropolitan State CDBG projects and funds was only 8 percent and 7 percent, respectively. The percentage of projects going to counties with persistent poverty declined from 8.6 percent in 1982 to 6.8 percent in 1986. However, persistent poverty counties represent only about 6 percent of the nonmetropolitan population, which means that relative to population, persistent poverty counties are slightly overrepresented in CDBG project distribution.

Per Capita Income

States funded projects in counties with average per capita incomes lower than their state's average per capita income. (Figure 19). Metropolitan counties receiving State CDBG funds had average per capita incomes 96 percent of the average per capita income of their state. Nonmetropolitan-funded counties had average per capita incomes that were only 85 percent of their state's average per capita income. Over time, states remained rather stable in funding counties with average per capita incomes lower than their state's average per capita income. In 1982 CDBG-funded counties had average per capita incomes that were 88 percent of their state's average per capita income, while in 1986 the percentage was 89 percent. The percentage remained within the 87 to 89 range in each of these five years.

Throughout the 1980s, per capita income in nonmetropolitan areas was less than the per capita income in metropolitan areas. When considering only nonmetropolitan county per capita income, states tended to fund nonmetropolitan counties with slightly higher per capita incomes. For example, the average 1979 per capita income for all nonmetropolitan counties was $5,750, while the average 1979 per capita income for nonmetropolitan counties with CDBG projects was $5,841. The comparable figures using average 1985 per capita income are $7,976 and $8,163, respectively.

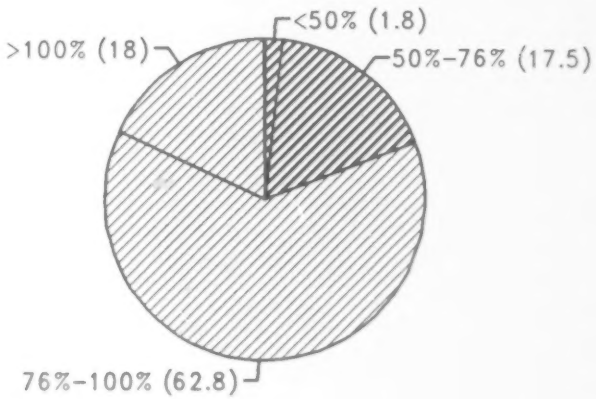
Comparing average national per capita incomes or poverty levels with averages for counties with CDBG projects can be misleading. The national distribution of CDBG funds, for example, is not based primarily on poverty or incomes, so mismatches between funds and distress as measured by poverty or income may occur.

Unemployment

State CDBG projects tended to be located in counties with unemployment rates higher than their state's average unemployment rate. Metropolitan counties with CDBG projects had an average unemployment rate 1.04 times their state's average unemployment rate, while nonmetropolitan counties with projects had an average unemployment rate 1.29 times their state's average unemployment rate. This is partly because nonmetropolitan unemployment rates tend to be higher than statewide unemployment rates.

More strikingly, about 68 percent of all the counties with CDBG projects had unemployment rates higher than their state's average unemployment rate (Figure 20, N = 3,303). The distribution of CDBG projects in nonmetropolitan areas strongly favored counties with relatively very high un-

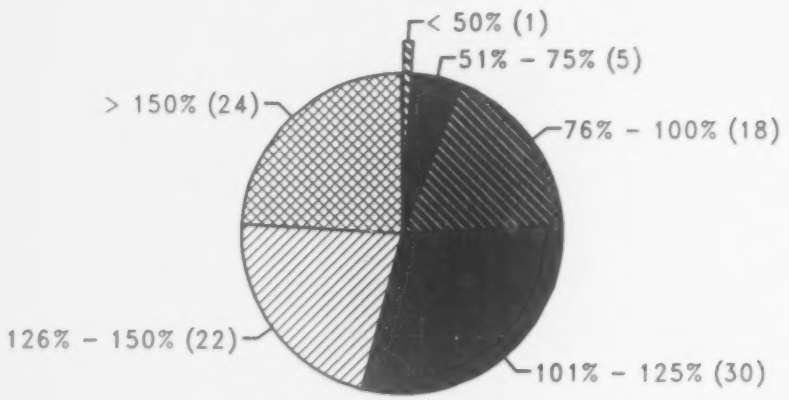
Distribution of CDBG-Funded Counties by Per Capita Income Relative to State's



Note: Percentage ranges measure per capita income of funded counties to per capita income of the state in which the funded county is located.

Figure 19

Distribution of CDBG-Funded Counties by Unemployment Rate Relative to State's



Note: Percentage ranges measure per capita income of funded counties to per capita income of the state in which the funded county is located.

Figure 20

employment rates. Almost 50 percent of the nonmetropolitan counties with CDBG projects had unemployment rates at least 25 percent higher than their state's average unemployment rate.

Population Growth

To a slight degree states distributed CDBG funds to areas that grew more slowly than areas that did not receive CDBG funds, as measured by population change between 1980 and 1986. About 42 percent of state CDBG funds went to counties in the bottom two quintiles of population growth (counties with percentage population growth rates of less than 0.7 percent), while about 36 percent of CDBG funds went to counties in the top two quintiles of population growth (counties with percentage population growth rates of more than 4 percent).

Substantial variations existed between metropolitan and nonmetropolitan areas, as illustrated by Figure 21 (N = 3,303). Forty-six percent of the funds distributed to nonmetropolitan areas went to counties with growth rates less than 0.7 percent, although these counties represented only 40 percent of all nonmetropolitan counties. One-third of the funds went to nonmetropolitan counties with growth rates of more than 4 percent, and these counties represented about 34 percent of all nonmetropolitan counties.

About 31 percent of the funds going to metropolitan areas went to counties with growth rates less than 0.7 percent, although these counties represented 34 percent of all metropolitan counties. Forty-three percent of the funds went to metropolitan counties with growth rates greater than 4 percent, and these counties accounted for 59 percent of all metropolitan counties.

The tendency to distribute more funds to slow growth areas was fairly consistent from 1982 through 1986. In 1982 over 46 percent of CDBG funds, the highest percentage during the five-year period covered by this study, were distributed to areas with growth rates less than 0.7 percent. The lowest percentage of funds distributed to these areas, about 36 percent, occurred in 1983, the year when 10 new states entered the program. Since 1983, the percentage of funds distributed to slow-growth areas has continued to increase, reaching 43 percent in 1986. In each year 1982 to 1986 less than 40 percent of CDBG funds were distributed to areas with a percentage growth rate of more than 4 percent.

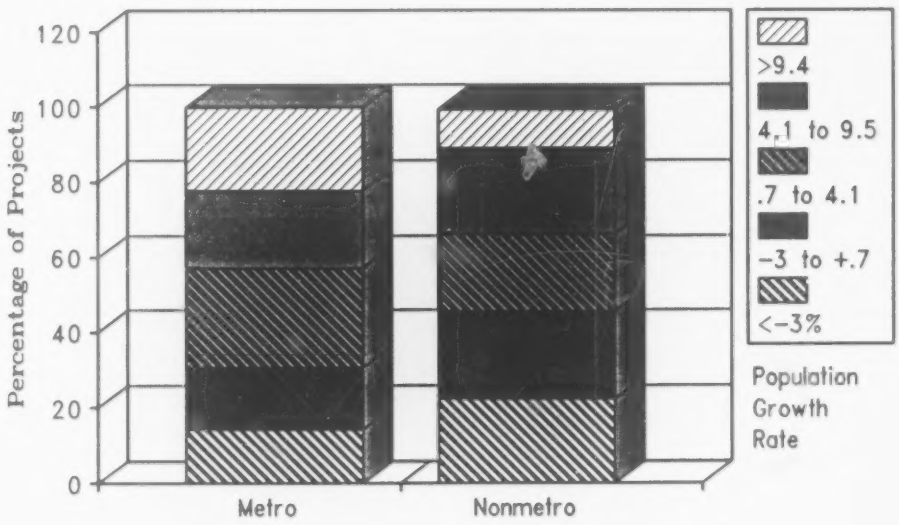

Project Distribution by County Growth Rate (1980–1986) by Metro/Nonmetro
Percentage of Projects
120
100
80
60
40
20
0
Metro
Nonmetro
>9.4
4.1 to 9.5
.7 to 4.1
−3 to +.7
<−3%
Population Growth Rate

Figure 21

Economic Development in Distressed Areas

This final section of this chapter examines the kinds of economic development activities undertaken in distressed counties, using the earlier measures of per capita income, unemployment, and the persistent poverty county designation. The major purpose is to compare economic development activities in the less well off counties to those in the better off counties. With the exception of poverty counties, which are all nonmetropolitan, this analysis includes projects in both metropolitan and nonmetropolitan areas.

Economic Development in Low Income Areas

Several patterns emerge in looking at the distribution of different types of economic development activity among counties based on per capita income levels. (Figure 22). First, counties with relatively lower per capita incomes had a higher percentage of business loan projects. Business loan projects comprised 75 percent of all economic development projects in counties with per capita incomes less than 50 percent of their state's average per capita. On the other hand, business loan projects constituted 66 percent of projects in counties with average incomes of 100 to 125 percent of their state's average. The percentage of economic development projects that were business loans tended to decrease as county per capita income relative to state income increased.

Second, counties with lower relative per capita incomes tended to assist a higher percentage of start-ups and interstate relocations. In the two lowest relative per capita income groups of counties, 31 percent of the business loan projects were start-ups, compared to about 25 percent in the groups of higher relative per capita incomes. About 5 percent of the business loan projects assisted interstate relocations in the two lowest relative income groups, compared to 10 percent in the two highest relative income groups. Perhaps the most striking note from Figure 23 is that 2 percent of the business loan projects in counties with the lowest relative incomes were retentions, compared to 9 percent for the highest income counties.

Third, counties with the lowest relative incomes tended to have projects assisting the smallest businesses. In counties with incomes less than 50 percent of their state's average incomes 90 percent of the business loans went to businesses with fewer than 26 employees.

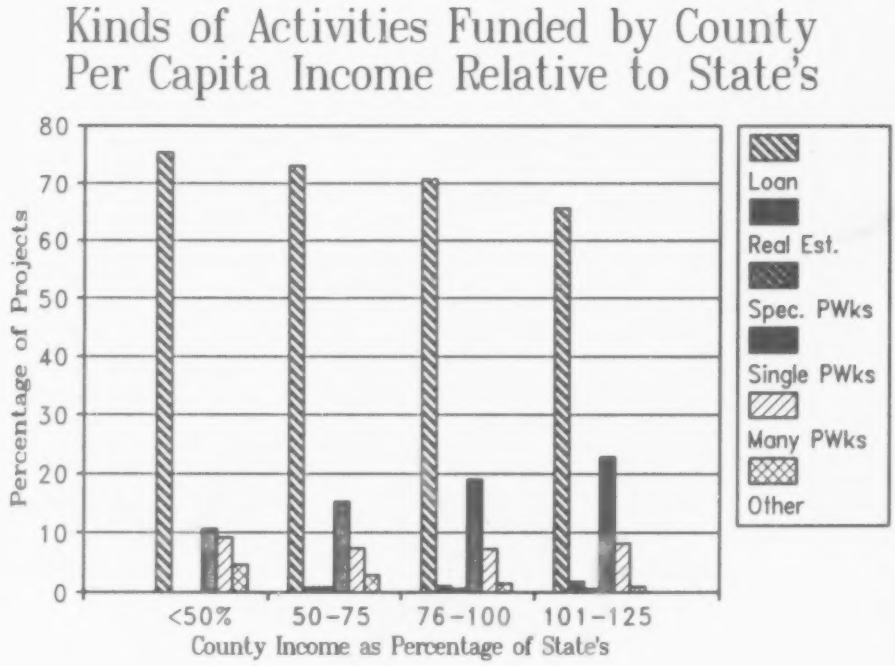

Kinds of Activities Funded by County Per Capita Income Relative to State's
Percentage of Projects
80
70
60
50
40
30
20
10
0
<50%
50-75
76-100
101-125
County Income as Percentage of State's
Loan
Real Est.
Spec. PWks
Single PWks
Many PWks
Other

Figure 22

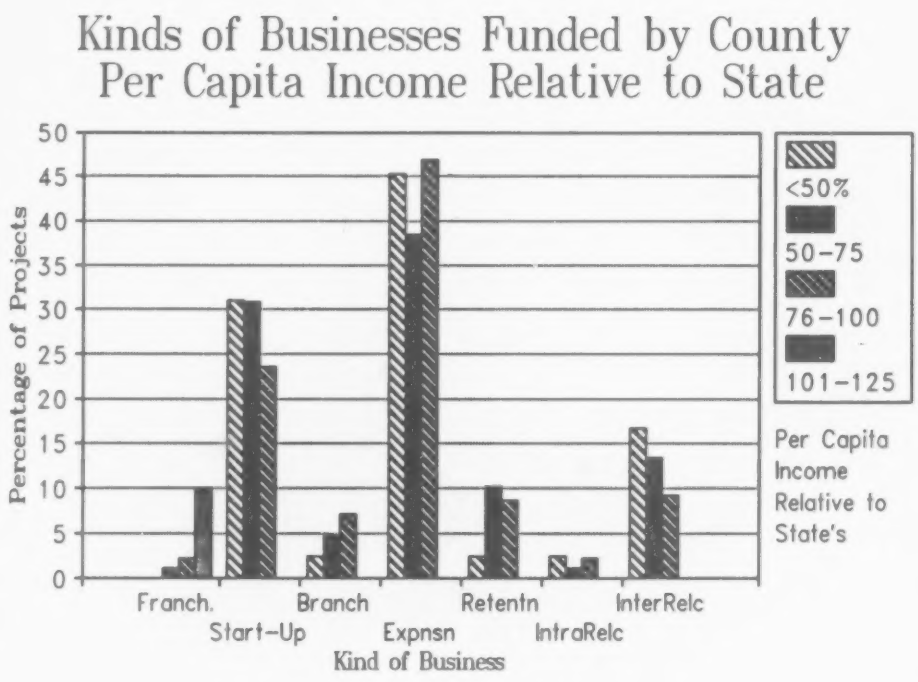

Kinds of Businesses Funded by County
Per Capita Income Relative to State
Percentage of Projects
50
45
40
35
30
25
20
15
10
5
0
Franch.
Start-Up
Branch
Expnsn
Retentn
IntraRelc
InterRelc
Kind of Business
<50%
50-75
76-100
101-125
Per Capita
Income
Relative to
State's

Figure 23

Economic Development in Persistent Poverty Counties

Economic development activity in persistent poverty counties displayed different patterns than those found in counties with relatively lower per capita incomes. Persistent poverty counties had a lower percentage of business loan projects than did non-poverty counties, 62 percent compared to 72 percent, and a higher percentage of public works projects, 34 percent compared to 24 percent. Persistent poverty counties had a higher level of both single-business and multiple-business public works projects.

The kinds of business activities funded and the size of businesses funded were similar in persistent poverty and non-poverty counties. Non-poverty counties had a slightly higher percentage of retention projects, while persistent poverty counties had a higher percentage of interstate relocations.

Persistent poverty counties funded manufacturing businesses much more frequently than did non-poverty counties. In poverty counties 81 percent of all loans went to manufacturing businesses compared to 67 percent for non-poverty counties.

Economic Development in High Unemployment Areas

Counties with higher relative unemployment rates tended to have a higher percentage of branch plants and retentions, but the variations were not large. Counties with unemployment rates greater than 150 percent of their state's average unemployment rate assisted a much higher percentage of very small businesses than did counties with lower relative unemployment rates. In the counties with the highest relative unemployment rate 80 percent of businesses assisted with loans had fewer than 26 employees, compared with a range of 64 to 74 percent for counties in the other five unemployment rate groups.

In Summary

Proportionately, more economic development projects were infrastructure projects in metropolitan areas than in nonmetropolitan areas. Metropolitan areas tended to fund more relocations than nonmetropolitan areas, while nonmetropolitan areas tended to fund more start-ups, branch plants, and franchises. Nonmetropolitan areas tended to fund relatively more very small businesses and relatively more very large businesses than did metropolitan areas.

About 70 percent of the projects in both metropolitan and nonmetropolitan areas assisted manufacturing businesses, but substantially more metropolitan

projects assisted businesses in the finance, insurance, and real estate industry and in the business service industry. Nonmetropolitan areas funded relatively more businesses in the wholesale trade and mining industries. Metropolitan and nonmetropolitan areas about equally funded retail trade businesses.

Slightly more than 80 percent of all planned employment was in manufacturing industries in both metropolitan and nonmetropolitan areas. A substantial share of planned employment in both metropolitan and nonmetropolitan areas was in routine manufacturing industries, 66 percent in metropolitan areas and 62 percent nonmetropolitan areas. However, a much higher percentage of planned jobs were for low- and moderate-income persons in routine manufacturing industries, 82 percent in nonmetropolitan areas and 66 percent in metropolitan areas.

As measured by planned job creation, manufacturing projects were larger than nonmanufacturing projects in nonmetropolitan areas, while in metropolitan areas nonmanufacturing projects were larger than manufacturing projects. In both metropolitan and nonmetropolitan areas, complex manufacturing projects were larger than routine manufacturing projects.

Public and private leveraging was higher in metropolitan areas. The average CDBG cost per job was higher in nonmetropolitan areas.

In many ways economic development activity was similar regardless of the extent to which a county was rural. However, with the risk of over-simplification, the more rural counties funded relatively more relocation projects, more manufacturing business projects, and more very small business projects than did the less rural counties.

Completely rural counties adjacent to metropolitan counties tended to fund relatively more start-up businesses than did the other rural counties. Infrastructure assistance projects were more numerous in counties adjacent to metropolitan counties. Relocation projects were more frequent in counties nonadjacent to metropolitan counties.

The distribution of economic development projects among counties of different economic bases was roughly proportional to the county's share of nonmetropolitan population. Manufacturing counties dominated the funding of branch plants, while branch plants were least funded in agricultural counties. Agricultural counties were the dominant funders of relocations, while manufacturing counties were the most minimal funders of relocations.

Manufacturing counties funded the largest share of manufacturing businesses, while federal lands and mining counties funded the smallest share of manufacturing businesses. Federal lands, mining, and government counties were the primary funders of start-up projects.

Between 1982 and 1986, states substantially funded nonmetropolitan areas, the more rural counties within nonmetropolitan areas, and very small communities. States strongly favored areas with unemployment rates much higher than their state's average unemployment rate. States also tended to fund areas with lower population growth rates. While states on the whole funded areas with lower per capita incomes and higher levels of poverty, this was in large part due to nonmetropolitan counties being less well off than metropolitan counties in these indicators of distress. When compared to national nonmetropolitan averages, states tended to fund areas that were slightly better off, in terms of per capita income and poverty. Because the population of persistent poverty counties is relatively small, their share of nonmetropolitan State CDBG funds and projects was greater than their share of nonmetropolitan population.

Economic development activities in poorer areas focused more on business loan projects than on infrastructure assistance projects, on start-up projects, on very small businesses, and on relocation projects. Persistent poverty counties presented an anomaly because they funded a relatively larger percentage of infrastructure projects than did nonpoverty counties. Persistent poverty counties also funded a much higher percentage of manufacturing projects and a higher percentage of retention projects than did non-poverty counties.

Examining economic development activity in distressed areas suggests that a traditional approach to rural economic development, attracting branch plants and interstate relocations, is still important in these areas. Also, long-term distressed areas may have little opportunity for entrepreneurial activity. They may have to use public works projects to attract businesses, particularly relocations and branch plants, and they may have to concentrate on manufacturing businesses. Also, distressed areas, perhaps with the exception of persistent poverty counties, may have to pay more attention to very small businesses than nondistressed areas. Finally, low per capita income, by itself, is not a significant impediment to business development.

IV. POLICY IMPLICATIONS

The State Community Development Block Grant Program is the federal government's primary program for loans and grants for rural economic development. Clearly, rural economic development through the State CDBG Program has moved well away from a traditional emphasis on relocations and branch plants. About 70 percent of the projects that received credit assistance through the CDBG Program assisted businesses that were expanding or starting their operations. Less than 13 percent of the projects assisted business relocations, and only 6 percent were branch plants. Perhaps inherent in the emphasis on expansions and start-ups is the program's substantial focus on very small businesses. Nearly 70 percent of the loan projects funded businesses with fewer than 26 employees.

This final chapter draws some concluding observations about rural economic development and public policies.

Using Different Tools for Rural Economic Development

One of the significant advantages of the CDBG Program is its flexibility; it is a multipurpose tool. To achieve job creation and retention, states used CDBG funds mostly for credit assistance and public works assistance to businesses, but states also used the program to fund day care, job training, feasibility studies, technical assistance, capacity building, and planning. This is one reasons why the CDBG Program is different from other programs. Other programs offer single tools, such as credit assistance, job training, or infrastructure assistance. This report studied two major types of economic development activities: credit assistance and infrastructure assistance.

Infrastructure Assistance

Although COSCAA collected more detailed information on business loan projects than on infrastructure assistance projects, several interesting themes on infrastructure projects emerged.

Infrastructure assistance projects were more prominent in metropolitan areas than in nonmetropolitan areas, and were most prominent in the outlying counties of metropolitan areas. Infrastructure projects were located in counties that had some degree of urban population or were adjacent to metropolitan counties. This may suggest that infrastructure assistance is an economic development tool more important to areas undergoing or facing urbanization than areas with relatively stable or declining populations or more

isolated areas. It also suggests that infrastructure may be particularly valuable in extending or enlarging existing public works capacity to meet the needs of an existing or relocating business.

Infrastructure assistance projects were more numerous in manufacturing and retirement counties. This reinforces the suggestion that infrastructure assistance is most useful in growing rural areas or to expand or extend public works capacity in relatively populous areas. Retirement counties are among the fastest growing nonmetropolitan counties, and manufacturing counties are the most urban nonmetropolitan counties.

Although no data was collected to confirm it, infrastructure projects probably assisted larger firms than did business loan projects. Most of these were manufacturing firms, perhaps even routine manufacturing industries, because of the much larger total costs, the much higher private leveraging, and the larger number of planned jobs of most infrastructure projects.

Persistent poverty counties' use infrastructure assistance stands out as an anomaly. Over one-third of all CDBG projects in persistent poverty counties were infrastructure projects. This is paradoxical because persistent poverty counties are the least urban of all nonmetropolitan counties, because over two-thirds of persistent poverty counties are nonadjacent to metropolitan counties, and because poverty counties are growing more slowly than the average nonmetropolitan county. One possible explanation for the high use of infrastructure assistance projects in persistent poverty counties is that they assisted relatively more manufacturing businesses and larger businesses.

The use of infrastructure assistance in the State CDBG Program dropped continuously from 1982 to 1986, from 43 percent of all projects to 22 percent. Much of the decline was based in the decreasing use of infrastructure assistance for multiple businesses, which fell from 18 percent of all projects in 1982 to 5 percent in 1986. A possible explanation for this precipitous decline is that 1982 was the bottom of the recession trough for rural areas, and as rural areas slowly began to improve, state and local government were under less pressure to assist large businesses through large-scale projects. Another explanation is that states and localities became better prepared to use loan assistance, perhaps relying on the administratively easier and more traditional infrastructure assistance early in the State CDBG Program.

Business Loans

Business loan projects continuously increased in importance from 53 percent of all projects in 1982 to 76 percent in 1986. They were nearly equally used throughout the rural continuum of counties. Agricultural, federal lands, and mining counties used loans more heavily than did counties with other economic bases. Thus, for rural economic development programming, the availability of loan funds, and the capability of a well-administered loan program, may be particularly important in agricultural, federal lands, and mining counties.

Although loans are a useful economic development tool nearly everywhere, there may be some problems using them in rural areas. A significant level of public or private leveraging, especially private leveraging, was difficult to achieve in the most rural counties. This means that another lender or the business itself may have less at stake than the government making the CDBG loan. As a result, the state and local government may have to manage the loan and provide oversight and technical assistance to the business. Since business loan projects are smaller than infrastructure projects and seem to create or retain less jobs per project, loans are much more administratively burdensome than infrastructure assistance.

Dilemmas of Rural Economic Development Policy

This study suggests that rural economic development policy must wrestle with two potentially difficult and significant issues: the substance of economic development, or the nature of the assisted businesses, and the location of rural development activities.

The Substance of Rural Economic Development

Most rural development literature says that for rural areas to achieve long-term economic success, they must diversify their economies, take advantage of and access the dynamic, strong, and growing service sector, and increase their labor force participation in complex industries. This theme is based on the premise that agriculture and natural resource industries are cyclical and do not have long-term, sustained growth; that complex manufacturing has a stronger future than routine manufacturing, with superior wages and working conditions; and that the service sector is the current and future basis of the national economy.

Yet, the State CDBG Program focused on manufacturing, not service industries, and when it did deal with services, most were not the kinds of strong

growth services that dominate urban areas. Seventy percent of the loans in nonmetropolitan areas were made to manufacturing businesses, while less than 3 percent were made to businesses in the finance, insurance, and real estate, and business service industries. Eighty-four percent of all planned jobs in nonmetropolitan areas were in manufacturing industries.

Within manufacturing, the State CDBG Program concentrated on routine manufacturing industries. In nonmetropolitan areas 43 percent of the loans, including loans to nonmanufacturing businesses, went to routine manufacturing industries, while 84 percent of the loans to manufacturing businesses were made to routine manufacturing businesses. Further, 66 percent of all planned manufacturing employment was in routine industries.

In 1984, 18 percent of all jobs in nonmetropolitan areas were in manufacturing, and 62.7 percent were in services, with 14 percent in business services. Within manufacturing, 72 percent of all jobs were in routine manufacturing industries (McGranahan, July 1987, 2-17). Planned employment in the CDBG Program heavily emphasized manufacturing, which contributed 84 percent of all planned jobs compared to manufacturing's 18 percent share in nonmetropolitan areas. Planned routine manufacturing jobs in CDBG-assisted businesses nearly matched the routine industries' actual share of nonmetropolitan manufacturing employment, 66 percent to 72 percent.

In one sense the State CDBG Program seemed to be helping the long-term future of the rural economy, because it funded proportionately slightly more planned jobs in complex manufacturing industries than complex manufacturing industries' share of nonmetropolitan employment. However, this conclusion is weakened by several facts. Nationally, routine manufacturing employment decreased by 11.7 percent between 1979 and 1986, while complex manufacturing employment increased by 2.9 percent. Second, routine manufacturing employment is projected to decrease by 2.9 percent between 1984 and 1995, while complex manufacturing employment is expected to increase by 17.8 percent. Finally, business service employment increased by 25.1 percent between 1979 and 1986 and is projected to increase by 27.1 percent between 1984 and 1985 (McGranahan, July 1987, 2-17).

One of the questions that must be asked is why the State CDBG Program did not provide more assistance to nonmanufacturing firms, especially business service firms, and to complex manufacturing industries. The data in this report permit only speculative answers. One answer is simply that the program assists those firms it has an opportunity to assist, and the opportunities may nearly always be manufacturing firms, especially routine manufacturing firms.

At the individual project or local government level, taking advantage of the economic development opportunities that arise may be appropriate and beneficial. Jobs are created or retained; businesses remain or grow or are established, and assistance to a specific routine manufacturing business may result in high quality, long-term jobs, and that business may become complex.

Another answer may reside in the program's requirement that 51 percent of the jobs be held by low- and moderate-income persons. All states use the 51 percent LMI test as a threshold requirement that all economic development applications must meet; many give a higher score to applications with a higher LMI job percentage. The LMI test is more easily met by routine manufacturing businesses. In the average routine manufacturing industry project, 74 percent of the planned jobs were LMI jobs compared to 53 percent in complex manufacturing. A lower percentage of planned jobs were LMI jobs in nonmanufacturing businesses than in manufacturing businesses, 76 percent to 81 percent. The data in this study also show that a large majority of the business projects and planned employment in metropolitan areas, where there are more complex industries than in nonmetropolitan areas, were in routine industries.

The low- and moderate-income national objective, then, may push State CDBG resources away from service businesses and toward manufacturing businesses, and within manufacturing away from complex industries and toward routine industries. The goal of providing employment assistance to lower- income persons through the CDBG Program may be inconsistent with the goal of strengthening the economy of rural areas for the long term.

The Location of Economic Development Assistance

Rural economic development policy must be concerned about the location of economic activity, because some rural areas need help much more than others, and some need no assistance. For example, nonmetropolitan counties adjacent to metropolitan counties grew much faster than nonmetropolitan counties nonadjacent to metropolitan counties from 1970 to 1980. The highest growth rate occurred in the rural-5 counties, 20.7 percent, and the lowest in the rural-4 group of counties, 13.9 percent. Also, recent studies indicate that high technology employment growth between 1977 and 1982 in nonmetropolitan areas was much higher in adjacent counties than in nonadjacent counties (Glasmeier, Smith, and Barkley).

The 1980 dependency ratios (the number of people under 18 and 65 or older compared to the number of people in the 18 to 64 age group) for the four most rural groups of counties (rural-3 to rural-6) were substantially higher than the

ratio for nonmetropolitan areas. Within these four groups, the dependency ratio increased as urban influence lessened, so that the dependency ratio of the most rural group of counties was 80, compared to the ratio of 66.1 for the rural-2 group of counties.

Median family income followed a similar pattern as the dependency ratio, with the rural-6 group of counties having a 1980 income of $14,149 compared to the $18,584 of the rural-1 group of counties. Finally, the 1979 poverty levels followed the same pattern as median family income. Rural-6 counties had a poverty level of 20 percent compared to the 12.1 percent of the rural-1 counties.

Although generalizations mask real differences, nonmetropolitan counties nonadjacent to metropolitan counties tend to have more of a need for economic development assistance than do those counties adjacent to metropolitan counties, and the more rural counties tend to have a greater need for assistance than the less rural counties.

The data in this study show that start-up and branch plant projects occurred relatively more frequently in nonmetropolitan areas than in metropolitan areas, and that within nonmetropolitan areas relocation projects occurred relatively more frequently in the more rural counties. The data also show that within nonmetropolitan areas the more rural counties tended to assist the smallest businesses relatively more frequently.

One conclusion that can be drawn is that trying to get industry relocations and trying to attract branch plants can still be an important economic development strategy in the more rural areas, but it is not nearly as important as strategies that deal with retentions, start-ups, and expansions.

A more significant conclusion is that very small businesses and, to a lesser extent, start-ups are most critical in the more rural areas, but this conclusion brings another policy dilemma. Very small businesses and start-ups need loan, not infrastructure, assistance. Yet, managing a loan assistance project is administratively more difficult than managing an infrastructure assistance project. Unfortunately, the least equipped local jurisdictions must often manage an administratively difficult form of assistance.

Moreover, assisting a very small business or a start-up project is much more difficult than assisting a branch plant, a retention, a relocation, or an expansion project. Very small businesses and start-ups are often unsophisticated businesses that can easily stumble and fail and need more than financial as-

sistance. Unfortunately, the least equipped local jurisdictions must cope with the most demanding kind of businesses in their assistance programs.

Persistent poverty counties present the most intractable problem. Although these counties tend to be more rural and nonadjacent to metropolitan counties, they relied much more heavily on infrastructure assistance than did nonpoverty counties with the same rural characteristics. Persistent poverty counties also assisted start-ups and very small businesses less frequently than did nonpoverty counties. Traditional infrastructure assistance for relocation and branch plant projects seemed to help persistent poverty counties the most, and alternatives just may not exist in these counties.

Policy Considerations

Rural economic problems and priorities vary widely not only across the country but also within nonmetropolitan areas. The kinds of tools needed to address rural economic problems and priorities also vary. For these reasons, any national rural development policy and programming must recognize the importance and desirability of decentralization and flexibility.

The State CDBG Program represents an excellent approach to rural economic development. First, it permits decentralized decision-making. Each state, in cooperation with its local governments and business community, can set its own priorities and implement its own economic development strategy. Second, the program permits a variety of tools to be used, from infrastructure assistance, to credit assistance, to job training, and even day care.

The statutory low- and moderate-income national objective may limit the CDBG Program's capability to assist the long-term viability of poor rural economies. Helping lower- income persons gain full employment and assisting distressed rural economies are both valuable goals, but they may not be fully compatible. However, there are several options directly within the State CDBG Program or through marginal changes to the program that could make it an even more effective rural economic development program.

One option is to make better use in rural areas of the national objective to prevent and eliminate slums and blight. This national objective now has an urban cast because it focuses on physical deterioration. Using the slum and blight national objective to undertake economic development in rural areas with high poverty levels, low incomes, and high unemployment rates would give the program added flexibility and power to increase economic activity in poor rural areas. Doing so would mean that job creation would be assisted without requiring that most of the employees be lower income. Funding

economic activity under the slum and blight national objective may not directly benefit as many lower income persons, but it may create conditions that could begin to turn around long-term distress, helping lower- income persons or over time. This would clearly be better than having these areas mired in distress decade after decade. [Long term very poor rural communities do not live in fear of being replaced by high income households and high land values.]

A second approach is for states to use more of the program's resources for activities that would directly improve the skills of lower- income employees. Customized skills development could include on the job training as well as basic skills and education, and possibly wage subsidies when employees are undergoing on-the-job training.

Particularly in isolated rural areas, effective customized skills development could be achieved most easily and effectively through the CDBG Program than by using the existing education and employment training resources. Many rural public education systems and JTPA organizations have neither the resources and competency nor image and reputation that would encourage businesses to use them.[8] CDBG-funded skills assistance is for the lower- income person and not the business in that once a person leaves the business his or her job skills go with him or her. It makes sense to treat skills development more as a public service activity than as assistance to a for-profit business. This would avoid the complicated, and for purposes of skills development the probably self-defeating, "necessary and appropriate" requirements promulgated by HUD. Moving in this direction would also require that the 15 percent limit on the percentage of CDBG funds that can be used for public services be applied to each state's program and not each individual recipient locality's grant as law now requires.

Finally, two changes would allow the State CDBG Program to help very small businesses and start-ups more effectively, especially in the more rural and poorer areas. One change would allow a state to require that program income be returned to the state. The current law requires that localities be allowed to keep program income if it is used for the "same activity." This change would provide for better management of funds and permit many small income streams to merge into a significant amount of money that the state could use to fund more cost effective economic development projects.

The second change would permit states to use more program resources for technical assistance and management support. It may be a better strategy to make fewer loans to very small businesses or start-ups and provide each business with support services to ensure success. This support could involve assistance, in marketing, production processes, management, accounting, or

inventory control. Doing this effectively may require some statutory changes. Current law requires that states distribute to local governments all but $100,000 plus 2 percent of their total CDBG allocations. Given both the importance of very small businesses and start-ups to rural economic development and the importance of support assistance to these businesses, states should be allowed directly to use program resources for support services without keeping such expenditures within their two and one-half administrative cap and to contract directly with business service providers to assist businesses funded by local governments. It may also mean that states would have to pay less importance to standards such as CDBG cost per job in their funding of applications.

These suggestions for change should not obscure the success and significance of states in using the CDBG Program to respond to a variety of rural economic problems, implement a variety of rural economic strategies, work in many different types of rural areas, especially in very rural areas and areas with high unemployment, assist many different kinds of businesses, particularly expansions, start-ups, and very small businesses, and employ a large number of persons, especially lower- income persons. In the 1980s, the State CDBG Program became the federal government's dominant rural economic development program and states became the lead players in designing and implementing rural economic development policy.

Appendix A:

Methodological Notes

In July 1988 COSCAA distributed a survey to each state agency that administered CDBG funds in any year from 1982 through 1986. A copy of the survey is in Appendix B. COSCAA staff had met with CDBG representatives of more than 20 states in February to discuss the study and survey content. Seven states completed a draft survey in April and May.

From August to November 1988 forty-six states plus Puerto Rico returned completed or partly completed surveys. Surveys were not sent to New York, Hawaii, or Maryland because these states did not administer the CDBG program in any year from 1982 through 1986.

From September through December, COSCAA reviewed the returned surveys and attempted to clear up any ambiguities or errors through phone calls to state agency personnel who completed the surveys. Each project funded through a single local revolving loan fund grant was identified as a distinct project. The survey information was put into a computerized data base. Using the 1986 City County Data Book and the data base that the U.S. Department of Housing and Urban Development (HUD) maintained for its Urban Development Action Grant Program, COSCAA identified the county where each project was located, and the community where each project was located if the grant recipient was a county and the project was located in unincorporated area. Each project was then matched to a corresponding FIPS code. Mt. Auburn Associates generated cross-tabulations from the data base using the SYSTAT statistical software program. Mt. Auburn also identified counties according to the U.S. Department of Agriculture's "Ross-Green" code.

Because the CDBG Program does not require detailed, uniform reporting from the states, not all states could provide all the data requested in the survey. Core information was received for 3,303 projects. When the text refers to a graph or a table, the number of projects for which the information is available is given in parentheses. Except where specifically noted, all the tables, graphs, and cells within the tables and graphs have an N of sufficient to summarize characteristics of the population from the sample.

The states of Alaska and Delaware did not fund any loan projects from 1982 through 1986, so the Alaska and Delaware projects are entirely infrastructure grants for economic development. Finally, Illinois' 1982 project documentation was archived and inaccessible, so the database contains no projects from

1982 for Illinois. The survey attempted to collect information on the businesses assisted only through business loan projects; no business information was collected on businesses assisted through infrastructure grants projects.

The data base includes information from Puerto Rico and Alaska, although Puerto Rico's counties are not included in USDA's economic base and Alaska's classification on the urban rural continuing classification.

Although the data base does not include projects from New York and Maryland, the urban to rural county continuum and the USDA economic base classification includes counties from these two states. This slightly lowers the figures given in the tables or graphs that use the national base for the total number of counties in the following economic base counties: manufacturing-dependent counties (New York has 15 and Maryland, three), in government-dependent counties (New York has six and Maryland, one), and in retirement counties (New York has five and Maryland, three). These counties comprise 2.7 percent of all manufacturing counties, 2.2 percent of all government counties, and 1.6 percent of all retirement counties.

This also lowers the figures given for the few tables and graphs that use the total number of nonmetropolitan counties in each of the six groupings of rural counties. New York has 12 rural-1 counties, two rural-2 counties, 12 rural-3 counties, three rural-4 counties, and one rural-5 county. Maryland has one rural-1 county, two rural-2 counties, one rural-3 county, two rural-4 counties, one rural-5 county, and two rural-6 counties. The nonmetropolitan counties from these two states comprise 7.5 percent of all rural-1 counties, 2.6 percent of all rural-2 counties, 2.3 percent of all rural-3 counties, 0.7 percent of all rural-4 counties, 0.8 percent of all rural-5 counties and 0.3 percent of all rural-6 counties. The total number of counties in each of the six rural groupings of counties is based on 1970 definitions (McGranahan, Hession, Hines, and Jordan).

APPENDIX B

PART II

CDBG AS A RESOURCE FOR RURAL DEVELOPMENT
INDIVIDUAL PROJECT SURVEY

STATE:_____

DEPARTMENT:_____

NAME:_____ PHONE:_____

This part of the survey is intended to gather information on features of individual economic development projects and will permit COSCAA to profile what types, where and under what conditions CDBG economic development projects are awarded. COSCAA will release no data on individual projects, the information obtained will be used for aggregate analysis. A survey form should be completed for each economic development project your department has funded since you started the program through 1986. Please make enough copies of this blank form before completing the survey. Please give each project a unique identifying number in the space provided.

INFORMATION ABOUT THE NAME AND LOCATION OF GRANT RECIPIENTS IS CRUCIAL AS COSCAA WILL BE SURVEYING A SAMPLE OF BUSINESSES THAT RECEIVED LOANS.

Definitions:

Owner/User Project - In an owner/user project the entity seeking assistance is a for-profit business and is also the owner/lessee and the occupant/user of the property.

Real Estate Project - In a real estate project the entity seeking assistance is a private developer who buys/builds/renovates a piece of property for another party.

Speculative Infrastructure - In a speculative infrastructure project the infrastructure that is provided is for private business use by an as yet unidentified business/businesses.

Infrastructure for an Identified Business - In this type of project, infrastructure is for an identified business/businesses whether or not the business has already taken up residence in proximity to the infrastructure.

Other - May include economic development feasibility studies, economic development planning, other technical assistance grants, job training.

Start-up - A start-up firm is a business that has started its operations within the last two years and is seeking outside financing for the first time.

Branch plant - A branch plant is a subsidiary of a parent firm that is starting a new portion or a new activity of the parent firm. The parent firm may be located inside or outside of the state.

Expansion - This refers to on-site expansion of an existing firm to enlarge production, thus adding new jobs.

Retention - A firm is retained when it averts closing and remains in the community; additional jobs need not be added.

Relocations - A relocated firm is one that moves any existing part or all of its activities to a new location. Relocations can occur both within and from outside a state.

Franchise - A firm which operates under an agreement with an organization which has developed a successful retail product or service where the firm obtains the right to engage in the business for a fee provided it agrees to follow the established pattern.

STATE:_____NAME:_____PROJECT#:_____

NAME OF LOCAL GOVERNMENT
RECEIVING GRANT: _____
ADDRESS:_____
CONTACT PERSON: _____
PHONE:_____

1. PROGRAM YEAR OF PROJECT _____

2. PROJECT DESCRIPTION_____
_____
_____

3. LOCATION OF PROJECT

(place name) _____

(county name) _____

4. TYPE OF PROJECT
(please refer to the definitions on page 1 before answering this question)

Owner/User Business Project _____
Real Estate Project _____
Speculative Infrastructure Project _____
Infrastructure for an Identified Business:
to benefit one particular business _____
to benefit a number of businesses _____
Other (please specify) _____

5. THE CDBG GRANT PROVIDED FUNDS TO ASSIST A:
(please refer to the definitions on page 1 before answering this question)

STATE:_____ NAME:_____ PROJECT#:_____

Note: This question does not apply to Speculative Infrastructure projects or to projects which provide infrastructure for a number of businesses. Please check only one alternative.

- Franchise _____
- Start-up _____
- Branch Plant _____
- Expansion _____
- Retention _____
- Relocation _____
  - Intrastate _____
  - Interstate _____
- Other (Specify) _____

6. TOTAL CDBG FUNDS ALLOCATED TO THE PROJECT _____

7. OTHER SOURCES OF FUNDING BY DOLLAR AMOUNT

- Federal Aid _____
- State IDB _____
- Local IDB _____
- Other _____
- Local Govt. Aid _____
- Other State Agency _____
- Local or Regional Dev. Organization _____
- Private Bank _____
- Owner's Equity _____
- Other (please specify) _____

8. PROJECTED JOB IMPACT OF THE PROJECT
(Projected at the time the award was made)

Total # of jobs to be created _____
Total # of jobs to be retained (if applicable) _____
# of LMI jobs to be created _____
# of LMI jobs to be retained (if applicable) _____

9. WAS ANY COMPONENT OF THIS PROJECT DONE IN CONJUNCTION WITH ANOTHER STATE AGENCY?

Yes_____ No_____

STATE:_____ NAME:_____ PROJECT#:____

If yes, Name of Agency _____

Type of assistance provided_____

_____

ONLY COMPLETE THIS SECTION IF THE PROJECT WAS TO PROVIDE DIRECT FINANCIAL ASSISTANCE TO AN OWNER/ USER BUSINESS

10. Name of Firm: _____ (firm filing application) Name of Firm: _____ (Project site if different)
    Address of Firm: _____ Address of Firm: _____
    Contact Person: _____ Contact Person: _____
    Phone: _____ Phone: _____

11. THE SIC CODE OF THE FIRM

12. FIRM OWNERSHIP

    - Minority _____ - None of these _____
    - Women _____ - Unknown _____

13. THE SIZE OF THE FIRM_____

    (The # of employees at the firm receiving the assistance at the time of application. For example, if the assistance was to finance a branch plant of a large parent firm, please give the # of employees of the entire parent firm.)

14. ALLOCATION OF CDBG ASSISTANCE AMONG DIFFERENT USES (Please specify dollar amount)

    - Working capital $_____ - Purchase of Land & Building $_____
    - Equipment _____ - Land Dev. and/or Construction _____
    - Other _____

STATE:_____NAME:_____PROJECT#:____

15. LOAN TERM (years) _____

16. INTEREST RATE (percent) _____

Fixed_____ Variable _____

17. STATUS OF THE LOAN

_____ Current
_____ Up to 60 days delinquent
_____ Over 60 days delinquent but not yet written off
(date of last payment_____)
_____ Written off
(date of written off_____)
_____ Paid off

18. WERE THE CDBG FUNDS SUBORDINATED TO THOSE OF ANOTHER LENDER?

Yes_____ No_____

19. WAS PRINCIPAL OR INTEREST DEFERRED IN THE LOAN AGREEMENT?

Principal Yes____ No ____ For How Long_____ (months)
Interest Yes____ No ____ For How Long_____ (months)

20. WAS PROGRAM INCOME RETAINED BY

- the state _____
- the local government _____

21. PROJECTED AMOUNT OF PROGRAM INCOME _____

22. WAS PROGRAM INCOME PUT IN A RLF FOR ECONOMIC DEVELOPMENT?

Yes_____ No_____ Don't Know_____

Appendix C

(N = 1,523)

Business Loan Projects by Industry
(R = Routine; C = Complex)

Industry	Metro	Nonmetro	All Projects
Mining	0.5%	0.9%	0.8%
Construction	2.7	2.3	2.4
Manufacturing			68.3
food & kindred products	5.8	7.1	6.9
textile mill products (R)	2.9	1.8	2.1
apparel and other textile products (R)	2.2	4.3	3.9
lumber and wood products (R)	4.1	8.3	7.2
furniture and fixtures (R)	4.1	4.6	4.5
paper and allied products (R)	3.2	1.1	1.6
printing and publishing (C)	1.5	1.7	1.6
chemicals and allied products (C)	.7	2.4	1.9
petroleum and coal products (C)	.5	0.0	.1

Industry	Metro	Nonmetro	All Projects
rubber and misc. plastics (R)	6.1	3.6	4.3
leather and leather products (R)	1.2	.6	.8
stone, clay, and glass products (R)	2.2	2.0	2.0
primary metal industries (R)	2.4	3.0	1.9
fabricated metal products (R)	8.3	6.8	7.2
machinery, excluding electrical (C)	10.2	7.5	8.2
electric and electronic equipment (C)	5.6	5.0	5.2
transportation equipment	3.4	5.3	4.8
instruments and related products (C)	2.4	1.3	1.6
misc. machinery (C)	1.9	2.3	2.2
Transportation, Communication, Utilities	2.7	3.0	3.0
Wholesale Trade	1.7	3.0	2.6
Retail Trade - Total	11.2	11.7	11.6
Food Stores	1.7	2.4	2.3

Industry	Metro	Nonmetro	All Projects
Restaurants	3.9	4.4	4.3
Finance, Insurance And Real Estate	3.4	1.2	1.8
Services	6.1	7.0	6.7
Hotels	1.2	2.0	1.8
Business Serv.	3.2	1.3	1.8

*NOTE: DOES NOT TOTAL 100% BECAUSE OF MISSING SIC CODES.

FOOTNOTES

[1] Many of the examples are taken from a recent National Governors' Association report, *New Alliances for Rural America, Report of the Task on Rural Development,1988.* An excellent review of state rural economic development programs is in *Reconnecting State Economies: Strategies for Coping with Rural Economic Development Issues* by SRI International.

[2] Unless otherwise indicated, the data in this section are from the Economic Research Service's *Rural Economic Development in the 1980's: Preparing for the Future.*

[3] Appendix A contains a discussion of methodology.

[4] The nonmetropolitan dollar amount for non-CDBG programs are derived by applying the percentage of federal funds that were spent in nonmetropolitan areas for fiscal year 1985 according to Elliott Dubin's *The Geographic Distribution of Federal Funds*. The table assumes that the percentage distribution in all years 1982 through 1986 was the same as in 1985. Dubin's report does not identify SBA's economic opportunity loans, so the table shows the percent distribution for direct small business loans {7(a)(11)}, of which the economic opportunity loans are a part. The nonmetropolitan share of MESBICs was taken from the percent distribution of direct SBIC loans, which are in effect MESBICs. The sources for the obligations are the federal agency budget offices. Loan guarantee programs are not included in the table to keep program types comparable since the CDBG Program is not used for loan guarantees.

Community-wide public works assistance can often be a necessary precondition for economic development in rural areas. COSCAA estimates that about $2.16 billion in State CDBG grants were distributed from 1982 to 1986 to nonmetropolitan areas for public works. This compares to about $2.71 billion in FmHA loans and grants for water treatment and wastewater disposal facilities and $2.47 billion in EPA wastewater construction grants. EPA's construction grant program, however, is changing to a revolving loan program at a reduced level of federal expenditures. This will make the State CDBG Program a critical rural public works resource in the 1990s as new or imminent EPA standards begin to affect rural communities.

[5] A franchise is a business that operates under an arrangement with an organization that has developed a successful retail product or service where the business obtains the right to engage in the business for a fee. A start-up is a business that has started its operation within two years of the time of the

CDBG investment. A branch plant is a business that is a new subordinate plant or subsidiary with the parent firm located in a locality other than the locality that contains the branch plant. An expansion is a business that is adding capacity at an existing site. A retention is a business at an existing site with an existing operation that would have closed or reduced its operation except for receiving State CDBG funds. An intrastate relocation is a business relocating all or part of its operation from one part of the state to another. An interstate relocation is a business relocatiing all or part of its operation from another state.

[6] However, a key issue in the debate over the importance of small business is the extent to which new rural businesses simply take away sales from other businesses in the community or region (Hite, 79).

[7] The job figures used in this report represent jobs that the state and the local grantee expected the business to create or retain as a result of the contract or grant agreement between the state and the local government. The job figures are not actual jobs created or retained. A second COSCAA report will address actual job creation and retention.

Economic development projects are usually closed out, that is deemed by states to be completed, two to three years after execution of the grant agreement between the state and the local government. Much can happen during that time, often beyond the control of the business, the local grantee, or the state, to alter the actual number and kinds of jobs created or retained, so that the actual job figures may be higher or lower than the planned job figures.

Also, the job figures in this report must be looked at in the light of two other factors. One is that most economic development is undertaken with the objective of creating secondary or even tertiary jobs. There is often some expectation that, say, if a firm expands by adding 100 new employees, other businesses in the community will also increase their employment. The job figures in this report deal only with direct job creation. Second, most of the State CDBG economic development funds are used by local governments as loans and not grants to the business. There is an expectation of payback; even when a business defaults, there is often at least a partial recovery of funds. Thus, the CDBG cost of a job is much less than the CDBG per job cost figures used in this report, which simply compares the initial funds spent on a project with the jobs created or retained from the project.

[8] The identifications of manufacturing industries as routine or complex follows that of McGranahan (July 1987, 2-19). The following two-digit SIC code industries are considered routine: food (20), tobacco (21), textile (22), apparel (23), lumber (24), furniture (25), paper (26), rubber (30), leather (31), stone, clay, glass(32), primary metals (33), fabricated metals (34), and miscellaneous manufacturing (39). The following are considered complex: printing (27), chemicals (28), petroleum (29), industrial machines (35), electrical equipment (36), and instruments (38), transportation (37) was not identified either as routine or complex because no three digit SIC codes were used. Transportation employment is eliminated from the base in the report's discussion of the shares of manufacturing employment belonging to routine and complex manufacturing industries. The use of two-digit SIC codes provides only a gross approximate division into routine or complex industries.

[9] One report notes that the JTPA Program "reached only 7 percent of those eligible and less than half of those received any occupational skills training at all. The bulk of funds went to job placement assistance. The most valuable form of training, on-the-job training, reached only 16 percent of TItle IV participants" (Shaw).

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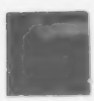

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